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# TRADE OR BUSINESS WITHIN THE UNITED STATES AS AN INTERPRETIVE PROBLEM UNDER THE INTERNAL REVENUE CODE: FIVE PROPOSITIONS

Anthony P. Polito\*

## I. INTRODUCTION

Does a particular set of activities constitute the conduct of a trade or business within the United States? This is an ongoing interpretive question affecting foreign taxpayers, both nonresident alien individuals<sup>1</sup> and foreign corporations.<sup>2</sup> An affirmative answer subjects a foreign taxpayer to net basis taxation to the extent of its “effectively connected income.”<sup>3</sup> For a

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1. I.R.C. § 7701(b) (2008). Throughout this Article the “Code” refers to the Internal Revenue Code and the “Service” refers to the Internal Revenue Service.

2. I.R.C. § 7701(a)(4)&(5) (2008).

3. I.R.C. §§ 871(b); 882 (2008). If a foreign taxpayer is engaged in a trade or business within the U.S. “at any time during the taxable year” U.S. net basis taxation applies. Treas. Reg. §§ 1.871-1(b)(1)(ii), 1.871-8(c), 1.881-1(a) (2008). Being subject to net basis taxation also imposes a return filing obligation, even for taxpayers with very little income subject to that taxation. I.R.C. § 6012. See *infra* notes 233, 239-242 and accompanying text. There is no middle ground. That is, there is no tax exemption based on being engaged in a trade or business within the U.S. for only part of a taxable year.

foreign corporation, it also causes the branch profits tax to apply to its effectively connected earnings and profits.<sup>4</sup> A negative answer results in flat-rate gross-basis taxation<sup>5</sup> of most types of U.S. source income, but it also results in no taxation at all of others, notably ordinary commercial sales of goods.<sup>6</sup>

Thus, unless a tax treaty provides otherwise, net basis taxation applies to a foreign individual that owns and operates a racehorse stable and brings a single racehorse into the U.S. to participate in a single race.<sup>7</sup> Likewise, because professional boxer Ingemar Johansson engaged in a single prize fight in the U.S. in each of 1960 and 1961, he was subject to U.S. net basis taxation in both of those years.<sup>8</sup> On the other hand, Piedras Negras Broadcasting Co.<sup>9</sup> was not subject to U.S. net basis taxation, even though its programming was geared toward a U.S. audience and about 95 percent of its advertising revenue was from U.S. persons.

There is no comprehensive definition of the term "trade or business" even in the domestic context. Nevertheless, in the domestic context one can say that it entails profit-oriented non-investment activity that is regular, continuous and considerable.<sup>10</sup> It is tempting, in the transition to the international context, to conclude that the conduct of a trade or business within the U.S. requires that a foreign taxpayer's U.S. activities must be regular, continuous, and considerable in and of themselves.

A number of courts have articulated the standard in this manner,<sup>11</sup> implying that some minimum quantum of U.S. activity is a necessary condition for a foreign taxpayer to be engaged in a trade or business within the United States. Understandably, many commentators have taken these statements at face value as the controlling standard.<sup>12</sup> Nevertheless, other

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4. I.R.C. § 884 (2008). Conduct of a trade or business within the U.S. also has certain ancillary consequences. An example is its effect on the source determination for some types of income. *Id.* §§ 861, 862, 884(f). The primary focus of this Article, however, is the threshold question of net basis taxation.

5. The crucial distinction between net basis taxation and gross basis taxation is that under the former regime a taxpayer's gross income is reduced by appropriate deductions allocated and apportioned to it, *id.* § 861(b), while in the latter regime no such reduction is permitted.

6. *Id.* §§ 871, 881, 882.

7. Rev. Rul. 58-63, 1958-1 C.B. 624, *amplified in* Rev. Rul. 60-249, 1960-2 C.B. 264.

8. *Johansson v. United States*, 336 F.2d 809, 817 (5th Cir. 1964).

9. *Comm'r v. Piedras Negras Broad. Co.*, 127 F.2d 260, 261 (5th Cir. 1942). The corporation in question was not engaged in a trade or business within the United States because it had no U.S. source income at all.

10. See *infra* notes 38-51 and accompanying text.

11. See *infra* notes 178-223 and accompanying text, distinguishing these cases on their facts and providing an analysis of why these assertions are not interpretively controlling.

12. See, e.g., Stephen R.A. Bates, Chris Bowers, Jeffrey P. Cowan, *Tax Planning for Providers of Cross-Border Services*, 106 TAX NOTES 1411, 1419 (2005); Alice Keane Putman, *Targeting the International Telecommunications Industry for U.S. Taxation. Selected Issues Regarding the Proposed Regulations for Sourcing International Communications Income*, 35 GEO. J. INT'L L. 149, 169 (2003);

authority holds that even sporadic or isolated activity in the U.S. is sufficient to cause a foreign taxpayer to conduct a trade or business within the United States.<sup>13</sup> Taken at face value, the coexistence of these variegated and seemingly contradictory authorities is problematic at best. Some of the same commentators point to the uncertainty thus created.<sup>14</sup> A standard treatise in the area observes that making the determination depend upon examining foreign taxpayers' U.S. activities without regard to their foreign trade or business activities presents, "[A] task straining the imagination if the [U.S.] activities would not have been undertaken absent the foreign business to which they are subservient."<sup>15</sup>

As an interpretive manner, is it possible to arrive at a principled reconciliation of this inconsistency? This Article answers that question in the affirmative.<sup>16</sup> It does so by disentangling the original inquiry into two distinct inquiries:

- Is the foreign taxpayer engaged in a trade or business?
- Is the conduct of the trade or business "within" the United States?

In doing so it advances a series of five distinct numbered propositions that creates an interpretive reconciliation of the various authorities addressing this question. Thus, if a taxpayer is not engaged in a trade or business at all anywhere in the world, it cannot conduct a trade or business within the United States, as articulated by *Proposition 1*. On the other hand, under *Proposition 2*, if the taxpayer's domestic activities, disregarding its foreign activities, are sufficient in themselves to constitute a trade or business, then the taxpayer clearly conducts a trade or business within the United States.

The more complicated situation is one in which the taxpayer does conduct a trade or business, but its domestic activities are not sufficient on their own to constitute a trade or business. The thesis advanced as

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David R. Sicular & Emma Q. Sobol, *Selected Current Effectively Connected Income Issues for Investment Funds*, 56 TAX LAW. 719, 736 (2003); Richard Crawford Pugh, *Policy Issues Relating to the U.S. Taxation of Foreign Persons Engaged in Business in the United States Through Agents: Some Proposals for Reform*, 1 SAN DIEGO INT'L L. J. 1, 6 (2000); Jonathan M. Ricci, *Electronic Commerce and Non-Resident Aliens: The Internal Revenue Service Versus International Cyberspace Transactions*, 6 RICH. J.L. & TECH. 7, 49-50 (1999); Boris I. Bittker & Lawrence Lokken, FUNDAMENTALS OF INTERNATIONAL TAXATION ¶66.3.2 (1997); Nancy H. Kaufman, *Common Misconceptions: The Function and Framework of "Trade or Business Within the United States,"* 25 VAND. J. TRANSNAT'L L. 729, 782-86 (1993).

13. See *infra* notes 78-84 and accompanying text.

14. See, e.g., Putman, *supra* note 12, at 170; Sicular & Sobol, *supra* note 12, at 736; Pugh, *supra* note 12, at 6-7. One observer simply notes that, whatever the threshold is, it is "quite low." Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507, 525 (1997).

15. Bittker & Lokken, *supra* note 12, at ¶66.3.2.

16. In some areas of tax law, a normative principle that has the capacity actually to guide interpretation is notably lacking. In such circumstances, it is necessary to rely on prescription. The problem of return of capital conventions is a prime example. See Anthony P. Polito, *The Role of Prescription in the Interpretive Problem of Basis Determination*, 53 TAX LAW. 615 (2000). Fortunately, this is not one such area.

*Proposition 3* is that, if a taxpayer does engage in a trade or business somewhere in the world, its U.S. activity does not itself need to be regular, continuous, and considerable to bring it into the United States. Thus, a separate quantitative test of U.S. activity is not necessary. On the other hand, on qualitative grounds, certain U.S. activities do not serve to bring a foreign trade or business into the United States. Thus, investment activities, which are not trade or business activities at all, do not contribute to bringing a foreign trade or business into the U.S., *Proposition 4*. Likewise, neither do ancillary, clerical, and ministerial activities so contribute, *Proposition 5*. In short, once the existence of a trade or business has been established, the question of whether it has been brought into the U.S. is *qualitative*, and not *quantitative*.

A *qualitative* test is necessary to explain a number of the authorities. A *quantitative* test, however, is not necessary. This Article concludes that authorities articulating a standard that contradicts *Proposition 3* are better explained on their facts as being resolved under *Propositions 1, 2, 4, and 5*, but there are authorities that require *Proposition 3*. Thus, notwithstanding language to the contrary, a better reconciling synthesis of the existing authorities is to interpret them as requiring a *qualitative*, and not a *quantitative*, analysis to decide whether a foreign trade or business has been brought into the United States.

At the outset, it is worth being explicit about what issues this Article does not address. First, the concept of conducting a trade or business within the U.S. is roughly parallel to the treaty concept of carrying on business within the U.S. through a permanent establishment.<sup>17</sup> In their respective spheres of application, each is essential for the application of U.S. net basis taxation to a foreign taxpayer. It is important to note that the standard of trade or business within the U.S. is generally broader than the permanent establishment concept that applies to taxpayers eligible for the benefits of a tax treaty. Thus, for example, a nonresident alien may be engaged in a trade or business within the U.S., but may not have a permanent establishment.<sup>18</sup> While the permanent establishment question is a pressing one for those foreign taxpayers eligible for treaty benefits, the mission of this Article is to make sense of the governing authorities dealing with the trade or business question under the Code.<sup>19</sup>

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17. See U.S. Model Income and Capital Tax Convention, art. 5, 1996; OECD Model Income and Capital Tax Convention, art. 5, 1977. For independent personal services there has been the roughly equivalent concept of the "fixed base." See U.S. Model Income and Capital Tax Convention, art. 14, 1996; OECD Model Income and Capital Tax Convention, art. 14, 1977.

18. *De Amodio v. Comm'r*, 299 F.2d 623, 625 (3rd Cir. 1962). See Rev. Rul. 85-60, 1985-1 C.B. 187. See also Robert L. Williams, *Permanent Establishments in the United States*, 29 TAX LAW. 277 (1976).

19. Likewise, this Article does not address issues of customary international law or constitutional law. See *infra* note 101.

Second, this Article's mission is interpretive and not to advocate a policy position.<sup>20</sup> A number of commentators have advocated various legislative modifications of the existing thresholds for the imposition of net basis taxation, especially as they apply to electronic commerce.<sup>21</sup> A particular concern is that the sale of goods and services directly into the U.S. via the internet might escape taxation entirely.

However, there appears little likelihood of any of these proposals coming to fruition in the near future. Congress has not achieved enough agreement within itself, or with the White House, to achieve much of anything in the way of long-lasting fundamental tax reform. It is fair to say that there is a very good chance of this picture remaining unchanged for a fair number of years into the future. The Treasury Department itself has expressed a preference for dealing with changing economics via adaptation of existing legal mechanisms.<sup>22</sup>

So long as this description of the policy playing field remains valid, the interpretation of the existing law is unavoidable. This Article's contribution is to clarify the interpretation of the existing standard of whether a foreign taxpayer has brought a foreign trade or business into the United States. *Proposition 3* implies that, under existing law, there is no quantitative barrier under the Code to the imposition of U.S. net basis taxation.<sup>23</sup> One hopes that this interpretive exercise, and the interpretive methodologies it illustrates, may be of some use to taxpayers, tax administrators, jurists, and those more generally interested in resolving interpretive problems under the Code.

## II. WHOSE ACTIVITIES?

A threshold consideration is determining which activities count in this analysis. Clearly, a foreign taxpayer's own activities are crucial to the analysis. Nevertheless, activities are frequently imputed to a taxpayer either

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20. Compare, e.g., Kaufman, *supra* note 12, at 729.

21. See, e.g., Oleksandr Pastukhov, *International Taxation of Income Derived from Electronic Commerce: Current Problems and Possible Solutions*, 12 B.U. J. SCI. & TECH. L. 310 (2006); Pugh, *supra* note 12; Arthur J. Cockfield, *Balancing National Interests in the Taxation of Electronic Commerce Business Profits*, 74 TUL. L. REV. 133 (1999); Jonathan M. Ricci, *Electronic Commerce and Non-Resident Aliens: The Internal Revenue Service Versus International Cyberspace Transactions*, 6 RICH. J.L. & TECH. 7 (1999); Avi-Yonah, *supra* note 14.

22. See UNITED STATES DEPARTMENT OF THE TREASURY, OFFICE OF TAX POLICY, SELECTED TAX POLICY IMPLICATIONS OF GLOBAL ELECTRONIC COMMERCE 17, 35 (1996), available at <http://www.treas.gov/offices/tax-policy/library/internet.pdf>.

23. It seems that, when viewed from the perspective of the Code, rather than income tax treaties, the primary problem in the field of electronic commerce arises from a single reported decision. *Comm'r v Piedras Negras Broad. Co.*, 127 F.2d 260 (5th Cir. 1942); see *infra* notes 126, 136-127 accompanying text.

from a fiscally transparent entity in which the taxpayer holds an ownership interest or from an agent. Throughout this Article, any references to a taxpayer's activities include activities imputed to it under these briefly outlined principles.

Shareholding is not sufficient by itself to impute activities from a corporation to its shareholders.<sup>24</sup> A different principle, however, applies to fiscally transparent entities. Any foreign taxpayers that are beneficiaries of an estate or trust conducting a trade or business within the U.S. are all treated as conducting a trade or business within the United States.<sup>25</sup> Likewise, any foreign taxpayers that are members of a partnership conducting a trade or business within the U.S. are all treated as conducting a trade or business within the United States.<sup>26</sup> That attribution can occur via a chain of tiered partnerships.<sup>27</sup>

That a partner is a limited partner, rather than a general partner, does not in any way impede the attribution of the partnership's conduct of a trade or business within the U.S. to the limited partner.<sup>28</sup> Characterization of a limited partner as a passive investor, under business entity law, does not affect the tax characterization. This principle presumably applies with equal force to the passive equity investors—the passive “members”—of the many “alternative” business entities, such as LLCs, LLPs, and LLLPs, to the extent that they are classified as partnerships for tax purposes.<sup>29</sup>

In addition to interests in fiscally transparent entities, U.S. activities of a foreign taxpayer's agents may cause it to be treated as conducting a trade or business within the United States.<sup>30</sup> Activities of persons with broad discretion to bind the foreign taxpayer are properly imputed to it.<sup>31</sup> While an exclusive relationship is a strong factor in favor of imputing the agent's activity to the principal for purposes determining whether there is a trade or

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24. See *De Vegvar v. Comm'r*, 28 T.C. 1055, 1061 (1957), *acq.* 1958-2 C.B. 3; *Estate of Banac v. Comm'r*, 17 T.C. 748, 754 (1951).

25. I.R.C. § 875(2) (2008). The Code provision makes no distinction between grantor and nongrantor trusts. *Id.* Cf. *De Krause v. Comm'r*, 33 T.C.M. (CCH) 1362 (1974).

26. I.R.C. § 875(1).

27. See *Johnston v. Comm'r*, 24 T.C. 920, 922 (1955); *Cantrell & Cochrane, Ltd. v. Comm'r*, 19 B.T.A. 16, 17 (1930).

28. See Rev. Rul. 75-23, 1975-1 C.B. 29; *see also* Rev. Rul. 87-80, 1987-2 C.B. 292 (obsoleting Rev. Rul. 75-23 on unrelated grounds).

29. See Treas. Reg. § 301.7701-3 (2008).

30. See, e.g., Steven R. Lainoff, Stephen Bates & Chris Bowers, *Attributing the Activities of Corporate Agents Under U.S. Tax Law: A Fresh Look From an Old Perspective*, 38 GA. L. REV. 143, 164 (2003). A corporation in which a foreign taxpayer owns stock can be, but is not inherently, the foreign taxpayer's agent. See, e.g., *Comm'r v. Bollinger*, 485 U.S. 340, 345-46 (1988); *InverWorld v. Comm'r*, 71 T.C.M. (CCH) 3231 (1996).

31. See, e.g., *Lewenhaupt v. Comm'r*, 20 T.C. 151, 162-63 (1953), *aff'd*, 221 F.2d 227 (9th Cir. 1955); *Adda v. Comm'r*, 10 T.C. 273, 276-78 (1948), *aff'd*, 171 F.2d 457 (4th Cir. 1948); Rev. Rul. 70-424, 1970-2 C.B. 150.

business within the United States,<sup>32</sup> even activities of independent agents have been imputed to foreign taxpayers.<sup>33</sup>

An important distinction is whether a relationship is a principal-agent relationship at all, as opposed to a purchaser-seller relationship. If a foreign taxpayer sells goods to a U.S. taxpayer for independent resale, the U.S. purchaser is not the agent of the foreign taxpayer.<sup>34</sup> Likewise, if a U.S. taxpayer sells goods to a foreign taxpayer for independent resale by the foreign taxpayer, the U.S. taxpayer is not an agent for the foreign taxpayer. This may be the case even if the U.S. taxpayer arranges to have the goods shipped directly to the foreign taxpayer's customers.<sup>35</sup> An important element of this distinction is the economic independence of the two legs of the transactions, including that a genuine purchaser takes on the economic risk of loss of the goods.<sup>36</sup>

### III. ENGAGED IN A TRADE OR BUSINESS SOMEWHERE IN THE WORLD?

*Proposition 1: A necessary condition to engage in a trade or business within the U.S. is that the taxpayer be engaged in a trade or business somewhere in the world.*

If, considering all of the activities properly attributable to it, a foreign taxpayer is not engaged in a trade or business at all, it certainly cannot be engaged in a trade or business within the United States. While this might seem self-evident in the abstract, it is an important point that needs to be made explicit. A case might purport to address whether a trade or business is being conducted within the U.S. but actually turn on the more fundamental issue of whether the taxpayer is engaged in a trade or business at all.<sup>37</sup>

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32. Rev. Rul. 76-161, 1976-1 C.B. 193; Rev. Rul. 70-424, 1970-2 C.B. 150. *See also* Di Portanova v. United States, 690 F.2d 169, 174 (Ct. Cl. 1982); Field Service Advisory 1996 WL 33321148 (Jan. 30, 1996).

33. *De Amodio v. Comm'r*, 34 T.C. 894, 906, 909 (1960), *aff'd*, 299 F.2d 623 (3d Cir. 1962); *Handfield v. Comm'r*, 23 T.C. 633, 638 (1955); *Investors' Mortgage Sec. Co. v. Comm'r*, 4 T.C.M. (CCH) 45 (1945); Rev. Rul. 55-617, 1955-2 C.B. 774. *Cf.* *Taisei Fire & Marine Ins. Co. v. Comm'r*, 104 T.C. 535, 546-47, 556 (1995) (imputing activities from independent agents for purposes of determining whether a taxpayer has a permanent establishment in the United States). *Contra* *Piedras Negras Broadcasting Co. v. Comm'r* 43 B.T.A. 297, 311-13 (1941), *aff'd* 127 F.2d 260 (5th Cir. 1942); TAM 8147001, 1979 WL 54280 (Jan. 3, 1979).

34. *Estate of Cadwallader v. Comm'r*, 13 T.C. 214, 220 (1949).

35. *British Timken, Ltd. v. Comm'r*, 12 T.C. 880, 887-88 (1949); *Amalgamated Dental Co. v. Comm'r*, 6 T.C. 1009, 1014-17 (1946).

36. *Cf.* Treas. Reg. § 1.861-7(c) (2008); U.S. Model Treaty Technical Explanation, art. 5, ¶6.

37. *See infra* notes 192-198 and accompanying text.



The Code uses the term "trade or business" in multiple contexts but contains no definition of that term, and neither do Treasury regulations. The relevant concepts have evolved judicially in the course of determining many individual cases. Much of the analysis in those decisions seems to proceed on the assumption that informed individuals share very definite understandings of these concepts, even if they are not able to formulate them in precise linguistic definitions. Symptomatic of this is the failure of any comprehensive general purpose definition to emerge from those court decisions.<sup>38</sup>

In reading the individual decisions, it is important to bear in mind that the meaning of expressions referring to "trade or business" may vary according to context. The Supreme Court has cautioned that this phrase may have slightly, but significantly, different meanings when used in different sections of the Code.<sup>39</sup> On the other hand, "Despite statements that the words 'trade or business' have many shades of meaning, and are subject to colloquial abuses, . . . the courts, quite understandably, have not regarded the various sections of the Code using that term as water-tight compartments."<sup>40</sup> The Supreme Court itself has made use of precedent under multiple Code sections to develop an overall sense of the term.<sup>41</sup>

A comprehensive discussion of the body of authority touching on the meaning of that term is beyond the scope of this Article.<sup>42</sup> Nevertheless, in addressing the question of foreign taxpayers, it is useful to make a couple of general observations about this classification issue. A useful way to develop a general sense of the term is to consider classifications to which it is held in contradistinction.<sup>43</sup>

A trade or business is not passive or sporadic. It implies regular, continuous, and considerable business activities.

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38. *Comm'r v. Groetzinger*, 480 U.S. 23, 27 (1987).

39. *Id.* at 27 n.8; *Snow v. Comm'r*, 416 U.S. 500, 503 (1974).

40. *Trent v. Comm'r*, 291 F.2d 669, 671 (2d Cir. 1961).

41. *See Groetzinger*, 480 U.S. at 27-31 (1987).

42. *See James E. Maule, Trade or Business Expenses and For-Profit Activity Deductions* (Tax Mgmt. Portfolio No. 505-2nd, 2003) (providing an analysis of many authorities relating to classification as a trade or business).

43. An underlying assumption of this analysis is that the activity under consideration is driven by a profit motive. Trade or business does not include activity without a profit motive. *See, e.g., Besseney v. Comm'r*, 379 F.2d 252, 256 (2nd Cir. 1967); *Doggett v. Burnet*, 65 F.2d 191, 194 (D.C. Cir. 1933). Certainly an activity is not a trade or business if its primary motivation is the generation of tax deductions; *See, e.g., Hagler v. Comm'r*, 86 T.C. 598, 624 (1986); *Elliot v. Comm'r*, 84 T.C. 227, 237 (1985); *Wheeler v. Comm'r*, 46 T.C.M. (CCH) 642, 644 (1983); *See also* I.R.C. § 183 (2008) (disallowing, in the case of individuals and S corporations, deductions for a non-profit motivated activity to the extent that they exceed the gross income derived by that activity). For a more extensive discussion of the role of profit motivation in identifying a trade or business, *see* Maule, *supra* note 42. This Article confines itself to circumstances in which the existence of a profit motivation is not in question.

The meaning of the phrases “engaged in business,” “carrying on business,” and “doing business” . . . either separately, or connectedly, convey the idea of progression, continuity, or sustained activity. ‘Engaged in business’ means occupied in business; employed in business. ‘Carrying on business’ does not mean the performance of a single-disconnected business act. It means conducting, prosecuting, and continuing business by performing progressively all of the acts normally incident thereto, and likewise the expression ‘doing business’, when employed as descriptive of an occupation, conveys the idea of business being done, not from time to time, but all the time.<sup>44</sup>

In the colorful expression of one judge, “The word [*business*], notwithstanding disguise in spelling and pronunciation, means *busyness*; it implies that one is kept more or less busy, that the activity is an occupation.”<sup>45</sup>

It is clear that the expression is “a very comprehensive term and embraces everything about which a person can be employed.”<sup>46</sup> The key is activity oriented toward the generation of income or profit. Thus, business does not require the sale of goods or services to others.<sup>47</sup> For example, a full-time gambler was held to be in the trade or business of gambling.<sup>48</sup>

Another crucial distinction is between trade or business on the one hand and investment on the other hand.<sup>49</sup> Profit oriented activity is necessary to the existence of a trade or business. Nevertheless, it is not sufficient, because, in a qualitative sense, investment activities do not amount to a trade or business. In a purely domestic context, the Supreme Court concluded that the managing of investments for one’s own account is not a business, regardless of the quantity of time or activity it entails and the value of the investment portfolio.<sup>50</sup> In this sense, the holding and managing of a portfolio of securities and other investments is seen in contradistinction to a quintessential business.

Treasury regulations provide a valuable example of this principle.

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44. *Lewellyn v. Pittsburgh, B&L.E.R. Co.*, 222 F. 177, 185-86 (3d Cir. 1915); *see also Inverworld v. Comm’r*, 71 T.C.M. (CCH) 3231 (1996).

45. *Snell v. Comm’r*, 97 F.2d 891, 892 (5th Cir. 1938) (emphasis added).

46. *Flint v. Stone Tracy Co.*, 220 U.S. 107, 171 (1911). *See also Trent v. Comm’r*, 291 F.2d 669, 671 (2d Cir. 1961) (“The words which Congress has long used to mark off . . . [a] ‘trade or business,’ . . . includes all means of gaining a livelihood by work, even those which would scarcely be so characterized in common speech . . .”).

47. *Comm’r v. Groetzinger*, 480 U.S. 23, 27-32 (1987).

48. *Id.*

49. *See, e.g., Dalton v. Bowers*, 287 U.S. 404, 407 (1932); *Burnet v. Clark*, 287 U.S. 410, 413-14 (1932); *Deputy v. du Pont*, 308 U.S. 488, 496 (1940); *Higgins v. Comm’r*, 312 U.S. 212, 213-18 (1941), *superseded by statute*, I.R.C. § 212(1) (2008), *as recognized in Estate of Rockefeller v. Comm’r*, 762 F.2d 264, 266 (2d Cir. 1985); *Putnam v. Comm’r*, 352 U.S. 82, 87 (1956); *United States v. Gilmore*, 372 U.S. 39, 44-45 (1963); *Whipple v. Comm’r*, 373 U.S. 193, 197 (1963).

50. *Higgins*, 312 U.S. at 217-18 (1941). *Compare* I.R.C. § 864(b)(2)(A)(ii) & (B)(ii) (2008).

Assume a foreign holding corporation that owns all of the voting shares in five operating subsidiaries, two of which are U.S. corporations. The foreign corporation does nothing other than shepherd its interests in the operating subsidiaries. Its chief executive officer is also the chief executive officer of one of the U.S. operating companies. The foreign corporation has an office in Cleveland, where the officer spends a substantial part of the year supervising the foreign corporation's interests in its subsidiaries and where he also performs his function as the executive officer of the U.S. company. Although the U.S. subsidiaries are subject to U.S. taxation, the foreign parent corporation is not engaged in a trade or business within the United States.<sup>51</sup>

If, considering all of the foreign taxpayer's economic activities on a worldwide basis, it is not engaged in a trade or business anywhere in the world, then it is not engaged in a trade or business within the United States. A taxable corporation is by its nature a profit-oriented entity, and it is a rare corporation that is sufficiently passive to be engaged in no trade or business at all. Nevertheless, it is possible for a corporation to be engaged solely in investment activities and to conduct no trade or business at all.<sup>52</sup>

Likewise, the fraction of individuals who engage in no trade or business at all is presumably quite small. Quite notably, any personal services performed as an employee constitute a trade or business.<sup>53</sup> Nevertheless, if an individual's entire income is from passive investments, that individual has no trade or business. That is true even if that individual's self-management of an investment portfolio is a full time occupation.<sup>54</sup>

Regardless of how common or rare this conclusion is, its implications are clear. If a foreign taxpayer does not engage in a trade or business anywhere in world, it cannot be engaged in a trade or business within the United States.<sup>55</sup>

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51. See Treas. Reg. § 1.864-3(b), Ex. (2) (2008).

52. See, e.g., *McCoach v. Minehill & Schuylkill Haven R.R. Co.*, 228 U.S. 295, 303 (1913) (concluding that a corporation that leased its entire business operation to another corporation was not engaged in a trade or business); Treas. Reg. § 1.864-3(b), Ex. (2). *But see* *Edwards v. Chile Copper Co.*, 270 U.S. 452, 455 (1926) (holding that a corporation organized solely to hold the stock of a subsidiary and provide financing to the subsidiary via the issuance of parent bonds was engaged in a trade or business); Rev. Rul. 78-195, 1978-1 C.B. 39 (allowing I.R.C. § 162 trade or business expense deductions to a corporation that was formed for the express purpose of investing in real property and that engaged in no commercial activity except to purchase a tract of unimproved, non-income-producing real property, which it held for two years and sold without having made any substantial improvements).

53. Treas. Reg. § 1.162-17(a) (2008).

54. *Higgins*, 312 U.S. at 218.

55. See, e.g., *Cont'l Trading, Inc. v. Comm'r*, 16 T.C.M. (CCH) 724 (1957), *aff'd*, 265 F.2d 40 (9th Cir. 1959).

#### IV. U.S. ACTIVITIES INDEPENDENTLY A TRADE OR BUSINESS

*Proposition 2: A sufficient condition to engage in a trade or business within the U.S. is that, disregarding the foreign taxpayer's foreign activities, its U.S. activities constitute the conduct of a trade or business.*

A foreign taxpayer's profit oriented non-investment U.S. activities may be sufficiently regular, continuous, and considerable to constitute the conduct of a trade or business entirely on their own. In that case, there is no doubt that the foreign taxpayer is engaged in a trade or business within the United States.<sup>56</sup> In such a circumstance, an analysis of the foreign taxpayer's foreign business activities is superfluous.

A good illustration of this principle is the application in *InverWorld, Inc. v. Commissioner*<sup>57</sup> of the Treasury's limited-applicability definition of whether an alien individual or a foreign corporation is engaged in the active conduct of a banking, financing or similar business within the United States.<sup>58</sup> Under the regulation, a nonresident alien individual or a foreign corporation is considered to be engaged in the active conduct of a banking, financing, or similar business within the U.S. if:<sup>59</sup>

- At some time during the taxable year the taxpayer is engaged in business within the U.S.; and
- The activities of the business consist of any one or more of several specified types of activities carried on, in whole or in part, within the U.S. in transactions with persons situated either inside or outside the United States.

The specified types of U.S. activities that can result in the active conduct of a banking, financing, or similar business are any of the following:

- Receiving deposits of funds from the public;<sup>60</sup>
- Making personal, mortgage, industrial, or other loans to the public;<sup>61</sup>
- Purchasing, selling, discounting, or negotiating any of notes, drafts, checks, bills of exchange, acceptances, or other evidences of

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56. See, e.g., *Pinchot v. Comm'r*, 113 F.2d 718, 719 (2d Cir. 1940); *Lewenhaupt v. Comm'r*, 20 T.C. 151, 163 (1953), *aff'd*, 221 F.2d 227 (9th Cir. 1955); *United States v. Balanovski*, 236 F.2d 298, 304 (2d Cir. 1956); Rev. Rul. 55-617, 1955-2 C.B. 774.

57. 71 T.C.M. (CCH) 3231, 3237-18 to 3237-19 (1996).

58. Treas. Reg. § 1.864-4(c)(5)(i).

59. *Id.*

60. *Id.* § 1.864(c)(5)(i)(a).

61. *Id.* § 1.864-4(c)(5)(i)(b).

- indebtedness for the public on a regular basis;<sup>62</sup>
- Issuing letters of credit to the public and negotiating drafts drawn under them;<sup>63</sup>
- Providing trust services for the public;<sup>64</sup> or
- Financing foreign exchange transactions for the public.<sup>65</sup>

On its face, the regulation invites certain objections to this line of reasoning. The application of the regulation requires a predicate determination that the taxpayer is engaged in a business within the United States.<sup>66</sup> Furthermore, this definition exists in the context of determining whether income is effectively connected with the conduct of a trade or business within the United States. Strictly speaking the definition relates only to the resolution of the whether income is “effectively connected”<sup>67</sup> and not to whether there is a trade or business or whether it is within the United States.

Nevertheless, at a conceptual level, it does provide some assistance in resolving the question of whether there is a trade or business within the United States.<sup>68</sup> The Tax Court found that InverWorld, Ltd., engaged in five of the six listed activities on a regular basis. It found this a convincing argument that its U.S. activities were sufficient in themselves to constitute a trade or business.<sup>69</sup> In addition, while dealing with public customers or clients is not a necessary condition to the existence of a trade or business,<sup>70</sup> regular provision of these banking services to the public negates the proposition that the taxpayer’s activities are for investment<sup>71</sup> rather than for trade or business.<sup>72</sup> In short, InverWorld’s profit oriented non-investment U.S. activities were sufficiently regular, continuous, and considerable to

62. *Id.* § 1.864-4(c)(5)(i)(c).

63. *Id.* § 1.864-4(c)(5)(i)(d).

64. *Id.* § 1.864-4(c)(5)(i)(e).

65. *Id.* § 1.864-4(c)(5)(i)(f).

66. *Id.* § 1.864-4(c)(5)(i).

67. *Id.* § 1.864-4(c)(ii). See also I.R.C. § 864(c)(4)(B)(ii)(c) (2008); Treas. Reg. § 1.864-5 (a).

68. *InverWorld, Inc. v. Comm’r*, 71 T.C.M. (CCH) 3231, 3237-18 to 3237-19 (1996).

69. *Id.* See *supra* note 56 and accompanying text. For this Article, *InverWorld* is pertinent for its methodology of finding the conduct of a trade or business within the United States. The Article has no stake in the argument as to whether the *InverWorld* court accurately applied the regulatory text to the facts of the case. See, e.g., Yaron Z. Reich, *Taxing Investors’ Portfolio Investments: Developments and Discontinuities*, 79 TAX NOTES 1465, 1473-74 (1998).

70. *Comm’r v. Grotzinger*, 480 U.S. 23, 28-32 (1987).

71. See, e.g., *Dalton v. Bowers*, 287 U.S. 404, 407 (1932); *Burnet v. Clark*, 287 U.S. 410, 413-14 (1932); *Deputy v. du Pont*, 308 U.S. 488, 496 (1940); *Higgins v. Comm’r*, 312 U.S. 212, 213-18 (1941), *superseded by statute*, I.R.C. § 212(1) (2008), as recognized in *Estate of Rockefeller v. Comm’r*, 762 F.2d 264, 266 (2d Cir. 1985); *Putnam v. Comm’r*, 352 U.S. 82, 87 (1956); *United States v. Gilmore*, 372 U.S. 39, 44-45 (1963); *Whipple v. Comm’r*, 373 U.S. 193, 197 (1963).

72. *InverWorld*, 71 T.C.M. (CCH) at 3237-19 to 3237-26 (holding the non-applicability of the I.R.C. § 864(b)(2) exclusions of investment-related trading from the determination of whether a taxpayer engages in a trade or business within the U.S.). See *infra* notes 117-121 and accompanying text.

constitute the conduct of a trade or business entirely on their own.

## V. FOREIGN TRADE OR BUSINESS BROUGHT INTO THE UNITED STATES

*Proposition 3: A foreign taxpayer's U.S. activities, in isolation from its foreign activities, need not constitute the conduct of a trade or business in order to cause a foreign trade or business to be conducted within the United States.*

The more complicated situation relates to a foreign taxpayer that does engage in some trade or business, but the U.S. activities of which are not quantitatively sufficient in themselves to constitute a trade or business. An argument can be made on policy grounds that the standard for finding a trade or business within the U.S. should set a minimum condition that the taxpayer's U.S. activities be sufficiently regular, continuous, and considerable to themselves constitute the conduct of a trade or business.<sup>73</sup> Nevertheless, purely as an interpretive matter, this Article rejects explicitly any assertion that a necessary condition for bringing a foreign trade or business into the U.S. is that a foreign taxpayer's U.S. activities must, in isolation from its foreign activities, themselves constitute the conduct of a trade or business. Instead, it concludes that the pertinent authorities are better read as standing for the proposition that no minimum quantum of U.S. activity is necessary to bring a foreign trade or business into the United States.

The Code contains specific categories of activities that are to be treated as either the conduct of a trade or business within the U.S. or not the conduct of a trade or business within the U.S., but it contains little direct guidance as to whether a foreign taxpayer's trade or business can be brought *within the U.S.* even though its U.S. activities do not themselves constitute a trade or business within the United States. Treasury regulations indicate, in a statement that is virtually impossible to contradict but that provides virtually no guidance, that whether a person is engaged in a trade or business within the U.S. is determined on the basis of the facts and circumstances in each case.<sup>74</sup> As a consequence, the Service will not ordinarily issue rulings on whether a foreign taxpayer is engaged in a trade or business within the United States.<sup>75</sup>

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73. See, e.g., Kaufman, *supra* note 12, at 782-86 (advocating such a standard should be adopted as a matter of sound policy).

74. Treas. Reg. § 1.864-2(e) (2008). See also Rev. Rul. 88-3, 1988-1 C.B. 268.

75. See Rev. Proc. 2007-7, 2007-1 I.R.B. 227. The list of areas in which the Service will not issue rulings is renewed annually in a revenue procedure published in the first Internal Revenue Bulletin of the year.

The one piece of general guidance the Code does provide is related to personal services. As a general rule, with very limited exceptions, the performance of any personal services within the U.S. constitutes the conduct of a trade or business within the United States.<sup>76</sup> Therefore, a foreign taxpayer's U.S. personal service activities do not need to be regular, continuous, or considerable to constitute a trade or business within the United States.<sup>77</sup>

Thus, for example, a single ten-week period of U.S. performances at a single hotel by a foreign revue constituted the conduct of a trade or business within the United States.<sup>78</sup> A foreign professional golfer that participated in a small number of tournaments in the U.S. was engaged in a trade or business within the United States.<sup>79</sup> A foreign professional boxer, Ingemar Johansson, participated in a small number of professional boxing matches in the United States. In particular, his entire economic connection to the U.S. for 1960 and 1961 was a single prizefight in each year.<sup>80</sup> A single economic transaction in each of 1960 and 1961 was sufficient to conclude that Johansson was engaged in a trade or business within the U.S. during each of those years.<sup>81</sup>

One might be tempted to assert that this principle applies only to personal services and does not apply to other types of economic connections to the United States. On the other hand, the principle has been extended beyond personal services. A foreign individual that owned and operated a racehorse stable brought a single racehorse into the U.S. to participate in a single race. The Service concluded that participation in that one race was sufficient to constitute the conduct *within the U.S.* of a trade or business.<sup>82</sup> The compensation from the horse's participation in the race

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76 I.R.C. § 864(b) (2008). Note that this is not in any way limited to employee services. There are very specific statutory exceptions to the general rule that apply in very limited situations. For a discussion of why these exceptions do not negate the thesis advanced by this Article, see *infra* notes 129-139 and accompanying text.

77. See Charles I. Kingson, *Taxing the Future*, 51 Tax L. Rev. 641, 655 (1996) (arguing that focusing on the amount of time that services are performed in a particular place "confuses the question of whether a person is doing business at all with whether he is doing business in a particular jurisdiction").

78. Rev. Rul. 67-321, 1967-2 C.B. 470.

79. Rev. Rul. 70-543, 1970-2 C.B. 172, *amplified by* Rev. Rul. 73-107, 1973-1 C.B. 376.

80. *United States v. Johansson*, 8 AFTR 2d 6001 (S.D. Fla. 1961).

81. *Johansson v. United States*, 336 F.2d 809, 813 (5th Cir. 1964). See also Rev. Rul. 70-543, 1970-2 C.B. 172, *amplified by* Rev. Rul. 73-107, 1973-1 C.B. 376. Another important point to bear in mind is the interaction of two separate principles. One is the general rule that any personal services performed within the U.S. constitutes the conduct of a trade or business within the United States. The other is the imputation of agents' activities to their principals. The result is that services performed within the U.S. by a foreign individual may result in both the individual and the individual's foreign principal conducting a trade or business within the United States. Both of them would be subject to U.S. net basis taxation. See Rev. Rul. 74-330, 1974-2 C.B. 278; Rev. Rul. 74-331, 1974-2 C.B. 281.

82. Rev. Rul. 58-63, 1958-1 C.B. 624, *amplified in* Rev. Rul. 60-249, 1960-2 C.B. 264. See also Rev. Rul. 70-543, 1970-2 C.B. 172 (concluding that income may be exempt from payor withholding if

was not for personal services, and it is immaterial whether the owner raced the horse himself or engaged a jockey for that purpose.<sup>83</sup> Given that even a single economic transaction involving very minor personal services is sufficient to bring a foreign trade or business into the U.S. to the extent of that one transaction, there does not appear to be any particularly good conceptual reason to conclude that either sales of goods or use of property for compensation must be substantial to have the same effect.<sup>84</sup>

In this regard, it is useful to contrast the limitation imposed by U.S. income tax treaties on the taxation of business profits. Under a typical bilateral income tax treaty, a foreign taxpayer's U.S. business profits are taxable only to the extent attributable to a permanent establishment.<sup>85</sup> A permanent establishment means a fixed place of business.<sup>86</sup> Among the specifically included examples are:<sup>87</sup>

- A place of management;
- A branch;
- An office;
- A factory; and
- A workshop.

In contrast, the Code contains no such minimum threshold connection to the U.S. to invoke net basis taxation.<sup>88</sup> It is true that, for six years, from 1936<sup>89</sup> through 1941,<sup>90</sup> the U.S. imposed net basis taxation on a foreign

the foreign taxpayer provides the appropriate certification that the income is being treated as income effectively connected with the conduct of a trade or business within the U.S.), *amplified by* Rev. Rul. 73-107, 1973-1 C.B. 376.

83. Rev. Rul. 70-543, 1970-2 C.B. 172, *amplified by* Rev. Rul. 73-107, 1973-1 C.B.

84. One might conceivably assert that, in these cases of minimal U.S. activity, the U.S. activity is sufficient in and of itself to be regular, continuous, and considerable, even viewed in isolation of any foreign activity. Such a reading would appear to strip that expression of all substantive meaning. If that proposition were true for such *de minimis* U.S. activity, one would be forced to conclude that there is no minimum quantum threshold to be engaged in a trade or business at all. Nevertheless, from that unlikely proposition would follow *a fortiori* that there is no minimum quantum threshold to bring a foreign trade or business into the United States.

85. See U.S. Model Income Tax Convention, art. 7, ¶1, 2006; OECD Model Income Tax Convention, art. 7, ¶1, 1997.

86. See U.S. Model Income Tax Convention, art. 5, ¶1; OECD Model Income Tax Convention, art. 5, ¶1. For independent personal services there has been the roughly equivalent concept of the "fixed base." See U.S. Model Income Tax Convention, art. 14; OECD Model Income Tax Convention, art. 14.

87. See U.S. Model Income Tax Convention, art. 5, ¶2; OECD Model Income Tax Convention, art. 5, ¶2. A permanent establishment also includes the activities of a U.S. dependent agent that has, and habitually exercises, the authority to conclude contracts that are binding on the foreign taxpayer. See U.S. Model Income Tax Convention, art. 5, ¶5; OECD Model Income Tax Convention, art. 5, ¶5.

88. See I.R.C. §§ 871(b), 882 (2008). Net basis taxation is limited to the amount of income that is effectively connected to the conduct of a U.S. trade or business, see I.R.C. § 864(c), but that concept limits the amount subject to net basis taxation not the applicability of net basis taxation. Nevertheless, the "effectively connected" concept serves as an important counterbalance to the harshness of imposing net basis taxation without a minimum quantitative threshold. See *infra* notes 102-110 and accompanying text.

89. Revenue Act of 1936, Pub. L. 74-740, ch. 690, §§ 211, 231, 49 Stat. 1648, 1714-15, 1717



taxpayer that either conducted a trade or business within the U.S. or had a U.S. office or place of business. There has never been a time, however, during which the Code has foreclosed net basis taxation in the absence of a U.S. office or place of business.

The American Law Institute proposed that the U.S. abandon the "trade or business within the U.S." standard for a "fixed place of business" standard.<sup>91</sup> Nevertheless, the U.S. has not adopted a "fixed place of business" standard as the threshold for the imposition of net basis taxation.<sup>92</sup> The "trade or business within the U.S." standard remains broader than the permanent establishment concept. Thus, a nonresident alien may be engaged in a trade or business within the U.S., even though its U.S. connections do not amount to a permanent establishment.<sup>93</sup>

Given the rejection of the opportunity to articulate the threshold as a "fixed place of business" standard, and that isolated economic transactions are sufficient to bring a foreign trade or business into the United States, there is no clear, or even discernable, point in existing law pegging a quantitatively minimum standard for bringing a foreign trade or business into the United States. In the absence of such a quantitative pegging point, the authorities under the Code are more reasonably read as indicating that even minor amounts of U.S. activity in the course of what otherwise constitutes the conduct of a foreign trade or business are sufficient to bring it into the United States. Thus, the question of whether activity is regular, continuous, and considerable relates to whether the activity is a trade or business at all. If that threshold is satisfied, there is a trade or business, even if it is conducted overwhelmingly abroad. Once the existence of a trade or business is established, even a minor amount of activity within the U.S. should be sufficient in principle to bring the trade or business into the United States to the extent of that activity. That is, an admitted trade or business is conducted within the U.S. to whatever extent and for whatever portion of a taxable year, great or small, the activity of that trade or business occurs in the United States.<sup>94</sup>

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(1935-36). See also Internal Revenue Code of 1939 §§ 211, 231. For the text of these provisions, see Pub. L. 76-1, 53 Stat. 1, 75-76, 78 (1939).

90. Revenue Act of 1942, Pub. L. 77-753, ch. 619, § 160(d), 56 Stat. 798, 861 (1942). See also Revenue Act of 1942, Pub. L. 77-753, ch. 619, § 101, 56 Stat. 798, 802 (1942) (setting effective date).

91. AMERICAN LAW INSTITUTE, FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES TAXATION 90-93 (1987).

92. The U.S. uses the "office or other fixed place of business" standard only in the limited circumstances to determine source of income for sale of goods, I.R.C. § 865(e), and whether certain limited classes of income are treated as effectively connected income, *id.* § 864(c)(4); Treas. Reg. § 1.864-4(c)(5)(ii) (2008). See also Treas. Reg. § 1.864-7 (defining "office or other fixed place of business").

93. *De Amodio v. Comm'r*, 34 T.C. 894, 906, 909 (1960), *aff'd* 299 F.2d 623 (3d Cir. 1962); Rev. Rul. 85-60, 1985-1 C.B. 187. See also Williams, *supra* note 18.

94. In this regard, it is worth noting that a foreign taxpayer is engaged in a trade or business within

One might object to this interpretation because it catches foreign taxpayers with low levels of U.S. business activity. For example, under this interpretation, a foreign taxpayer engaged a foreign trade or business conducts it within the U.S. to the extent that it engages in a single sales transaction within the United States. What is the result under the Code<sup>95</sup> of the seeming harshness this of this result? First, in most circumstances other, qualitative, grounds would prevent this type of limited connection from constituting the conduct within the U.S. of a trade or business.<sup>96</sup> Second, an exceedingly small modicum of advance tax planning suffices to ensure that an isolated sale of goods into the U.S. generates foreign source income that is not subject to U.S. taxation at all.<sup>97</sup> Third, even in many cases in which the correct interpretation of the statute requires the imposition of U.S. taxation, very low levels of U.S. income may simply “fly below the radar screen” and go untaxed simply because they are unnoticed. Fourth, in many such cases, it may well be that the I.R.S. exercises its discretion to conclude that the amount of revenue at stake is not worth the cost of enforcement.<sup>98</sup>

The cost of administration may well cause the I.R.S. simply to ignore the unpaid tax in such cases. That, however, is a matter of wise husbanding of scarce administrative resources, of administrative grace to taxpayers, or of both. It is not a function of the interpretation of the Code. Any such administrative disregard of minor business dealings in the U.S. does not imply that those taxpayers are not engaged in trade or business within the United States.

If a foreign trade or business enters the U.S. for one transaction, then it is engaged in a trade or business within the U.S., but only to the extent of that one transaction. Admittedly, this reading of the law presents a very

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the U.S. if it is so engaged “at any time during the taxable year . . .” Treas. Reg. §§ 1.871-1(b)(1)(ii), 1.871-8(c), 1.881-1(a).

95. This analysis assumes the absence of an applicable income tax treaty that might override this conclusion, *see supra* notes 17-19 and accompanying text, in order to maintain its focus on the interpretive problem under the Code.

96. Concluding sales from entirely outside the U.S., without the involvement of any U.S. office or agent, should serve this function in most circumstances. *See Comm’r v. Piedras Negras Broad. Co.*, 127 F.2d 260, 261 (5th Cir. 1942). More generally, *see infra* notes 122-142 and accompanying text.

97. Arranging for the sale to be concluded—for title and risk of loss to pass to the purchaser—while the goods are outside of the U.S. suffices make the income foreign source not subject to U.S. taxation, so long as the foreign taxpayer does not maintain an office or fixed place of business in the United States. I.R.C. §§ 861(a)(6), 862(a)(6), 865(e); Treas. Reg. § 1.861-7(c). Of course, if a foreign taxpayer makes a sale of goods attributable to its U.S. office or fixed place of business, it may generate U.S. source income. I.R.C. § 865(e)(2). On the other hand, such a taxpayer has no legitimate objection to the conclusion that it is conducting a trade or business within the United States.

98. *See infra* notes 193-195 and accompanying text. These four explanations may also go a long way toward explaining the dearth of pertinent reported cases involving low volumes of sales of goods within the United States. An additional possible explanation is that the tax involved in such circumstances is sufficiently minor that taxpayers do not challenge the I.R.S. when it assesses the tax.

low threshold for bringing a foreign trade or business into the U.S., and thereby subjecting it to U.S. net basis taxation<sup>99</sup> and, in the case of corporations, the branch profits tax.<sup>100</sup> However, the last proviso is the critical qualification. The imposition of the tax under the Code is measured, and limited, by the extent to which the foreign trade or business is brought into the United States.<sup>101</sup>

## VI. EFFECTIVELY CONNECTED CONCEPT AS LIMITING COUNTERBALANCE

The "effectively connected" concept<sup>102</sup> significantly mitigates the seeming harshness of *Proposition 3*. Net basis taxation applies only to income that is effectively connected with the conduct of a trade or business within the United States.<sup>103</sup> The branch profits tax applies only to effectively connected earnings and profits.<sup>104</sup> Thus, the effectively connected concept serves as an important counterbalance to the broad definition of conducting a trade or business within the United States, because it controls the extent of U.S. taxation.

There is one point at which this counterbalancing appears superficially to break down; U.S. source non-capital gain income sales. This income is

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99. I.R.C. §§ 871(b), 882.

100. *Id.* § 884.

101. One might argue that taxing a foreign person to the extent of its limited conduct of its trade or business within the U.S. violates either the Due Process Clause of the U.S. Constitution's Fifth Amendment or customary international law. Strictly speaking, these points are not relevant to this Article, the mission of which is to interpret the language of the Code. Nonetheless, they appear to be issues worthy of further examination. As a preliminary matter, viewed on their merits, they strike the author as dubious. In the international context, the Constitution has been interpreted to impose very little limitation on the federal government's taxing authority, and the Supreme Court has not seen fit to revisit it jurisprudence in this area. See *Burnet v. Brooks*, 288 U.S. 378, 401-05 (1933); *Cook v. Tait*, 265 U.S. 47, 55-56 (1924). Even if one were to import Fourteenth Amendment due process concepts into this area, the constitutional argument remains highly contestable. If a foreign person purposefully avails itself of the benefits of the U.S. economic market for even a single transaction, then it is reasonable for the U.S. to tax that one transaction. *Cf. Quill Corp. v. North Dakota*, 504 U.S. 298, 307 (1992); *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 474-76 (1985). The purposeful availment analysis seems reasonable in terms of the customary international law argument as well. *Cf. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES*, §§ 411(2)(b), 412(4) (1987). Moreover, notable tax law scholars have doubted the notion that there even is any customary international law with respect to taxing jurisdiction. See, e.g., Martin Norr, *Jurisdiction to Tax and International Income*, 17 TAX L. REV. 431, 438 (1962); Stanley S. Surrey, *Current Issues in the Taxation of Foreign Corporate Investment*, 56 COLUM. L. REV. 815, 817 (1956); Harold Wurzel, *Foreign Investment and Extraterritorial Taxation*, 38 COLUM. L. REV. 809 (1938). In any case, it is clear that the Supremacy Clause requires U.S. courts to enforce the Code in preference to any such customary international law, until and unless Congress amends the former. See U.S. Const. art. VI, cl. 2.

102. I.R.C. § 864(c).

103. *Id.* §§ 871(b), 882.

104. *Id.* § 884(b), (d), (f).

swept into effectively connected status via the “limited” or “residual” force of attraction principle.<sup>105</sup> Thus, if a foreign taxpayer is considered to conduct a trade or business within the U.S., any U.S. source income from the sale of goods is effectively connected.

Here a valuable illustration from the Treasury is worth noting. A foreign corporation, which uses the calendar year as the taxable year, is engaged in the business of purchasing and selling electronic equipment. The home office of the foreign corporation also is engaged in the business of purchasing and selling vintage wines. During 2007, the foreign corporation establishes a branch office within the U.S. to sell electronic equipment to customers, some of whom are located within the U.S. and the balance in foreign countries. This branch office is not equipped to sell, and does not participate in sales of, wine purchased by the home office. Negotiations for the sales of the electronic equipment take place in the U.S. By reason of the activity of its branch office in the U.S., the foreign corporation is engaged in business within the U.S. during 2007. As a result of advertisements that the home office of the foreign corporation places in periodicals sold in the U.S., customers in the U.S. frequently place orders for the purchase of wines with the home office in the foreign country, and the home office makes sales of wine in 2007 directly to those customers without routing the transactions through its branch office in the United States. The income or loss from sources within the U.S. for 2007 from sales of electronic equipment by the branch office, together with the income or loss from sources within the U.S. for that year from sales of wine by the home office, is treated as effectively connected for that year with the conduct of a business within the U.S. by the foreign corporation.<sup>106</sup>

Nevertheless, even here the failure to control the extent of U.S. taxation is more superficial than real. The impact of this limited force of attraction can be significantly mitigated by placing the U.S. branch in a legally distinct corporation from the foreign business making direct sales into the U.S., and by ensuring that the former is not an agent of the latter.<sup>107</sup> If the electronic equipment business in the example were isolated in this way from the wine marketing business, the latter’s sales would not be swept into the former’s effectively connected income.<sup>108</sup> The wine business would most likely not be considered the conduct of a trade or business within the United States.<sup>109</sup>

Thus, the effectively connected concept does significantly mitigate the

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105. *Id.* § 864(c)(3).

106. Treas. Reg. § 1.864-4(b), Ex. (3) (2008).

107. See *supra* notes 24-36 and accompanying text.

108. I.R.C. § 864(c).

109. See *infra* notes 122-142 and accompanying text. The ease with which sales of goods income can be “resourced” as foreign, further mitigates the effect. See *supra* note 97.

effect of a low-threshold interpretation of what is necessary to bring a foreign trade or business into the United States.<sup>110</sup> In short, the inquiry into whether a foreign taxpayer engages in a trade or business within the U.S. determines only the possibility of U.S. net basis taxation and branch profits taxation. It is the effectively connected concept that determines the extent of that U.S. taxation.

## VII. QUALITATIVE EXCLUSIONS FROM THE U.S.

Nevertheless, if *Proposition 3* is to be useful in practice, it is still necessary to deal with the authorities that conclude that some U.S. activities do not amount to the conduct of a trade or business within the United States. Even in the absence of a minimum quantum of activity necessary to be engaged in a trade or business within the U.S., it is not the case that any connection to the U.S. is sufficient to bring a foreign trade or business into the United States. Some types of activity are qualitatively insufficient to bring a foreign trade or business within the U.S., regardless of how regular, considerable, and continuous they are.

### A. INVESTMENT ACTIVITIES DO NOT COUNT

*Proposition 4: U.S. investment activities do not contribute to bringing a foreign trade or business into the United States.*

As a first cut, investment activities are distinguished from trade or business activities. Investment income and the management of one's own investments, in and of themselves, are not considered a trade or business at all.<sup>111</sup> Based on the same principle, a foreign taxpayer is not considered to conduct a trade or business within the U.S. if its U.S. income is limited to investment income.<sup>112</sup>

In *Scottish American Investment Co. v. Commissioner*,<sup>113</sup> foreign investment corporations made extensive use of their U.S. office to collect revenues, make remissions to the home offices, maintain records, exercise

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110. For a more extensive discussion of effectively connected concepts, see 2 Philip F. Postlewaite, INTERNATIONAL TAXATION: CORPORATE AND INDIVIDUAL §§ 19.11 through 19.22 (3rd ed. 1998).

111. *Higgins v. Comm'r*, 312 U.S. 212, 218 (1941), *superseded by statute*, I.R.C. § 212(1) (2008), as recognized in *Estate of Rockefeller v. Comm'r*, 762 F.2d 264, 266 (2d Cir. 1985).

112. See, e.g., *Cont'l Trading, Inc. v. Comm'r*, 265 F.2d 40, 43-45 (9th Cir. 1959); *Consolidated Premium Iron Ores Ltd. v. Comm'r*, 28 T.C. 127, 147, 150 (1957); *Neill v. Comm'r*, 46 B.T.A. 197, 198 (1942). Cf. I.R.C. § 864(b)(2)(A)(ii) & (B)(ii).

113. 12 T.C. 49 (1949).

voting rights, and perform ancillary accounting functions.<sup>114</sup> None of this amounted to the conduct of a trade or business within the United States.<sup>115</sup> Their real business was the cooperative management in Scotland of British capital, a large part of which was invested by them in American securities via transactions in securities that were handled directly by the home offices through resident brokers.<sup>116</sup>

Consistent with this principle, certain statutorily specified U.S. activities related to trading in stocks, securities, and commodities do not constitute the conduct of a trade or business within the United States. Viewed in isolation, these activities should not constitute a trade or business. In addition, they do not serve by themselves to bring a foreign trade or business into the United States.

In particular, trading in stocks, securities, or commodities is not a trade or business within the U.S. if:<sup>117</sup>

- Done through a resident broker, commission agent, custodian, or other independent agent; and
- There is no time during the year at which the taxpayer has an office of fixed place of business within the U.S. through which or by the direction of which the transactions in stock, securities, or commodities are effected.

In addition, trading in stocks, securities, or commodities for the taxpayer's own account are not a trade or business within the U.S. regardless of:<sup>118</sup>

- Whether the trading is done by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and
- Whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions.

This exception for trading for one's own account, however, is not available to dealers.<sup>119</sup>

Consistent with the thesis of a qualitative, rather than quantitative, standard, the volume of trading does not affect the applicability of these exclusions from being a trade or business within the United States.<sup>120</sup> That a taxpayer does not satisfy one of these rules relating to stock, securities, or commodities for exclusion from conducting a trade or business within the

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114. *Id.* at 56.

115. *Id.* at 59.

116. *Id.*

117. I.R.C. § 864(b)(2)(A)(i), (2)(B)(i), & (C).

118. *Id.* § 864(b)(2)(A)(ii) & (2)(B)(ii).

119. *Id.* § 864(b)(2)(A)(ii)&(2)(B)(ii). See also Treas. Reg. § 1.864-2(c)(2)(iv) (2008) (defining dealer in stock or securities).

120. Treas. Reg. § 1.864-2(c)(1).

U.S. does not, by itself, prove the reverse. That is, failing the exclusion test is not enough to prove the existence of a trade or business within the United States. That must be determined on the taxpayer's particular facts and circumstances.<sup>121</sup>

## B. ANCILLARY, CLERICAL, AND MINISTERIAL ACTIVITIES

*Proposition 5: Ancillary, clerical, and ministerial activities do no contribute to bringing a foreign trade or business into the U.S., without regard to their extensiveness.*

Even once *Proposition 4* is taken into account, a number of authorities remain concluding that non-investment U.S. activities fail to bring a foreign trade or business into the United States. That exclusion, however, is not predicated on the extent of those activities. The key aspect is that they are only tangentially related to the conduct of a trade or business.

A number of these tangential activities can be distilled and cataloged:

- Investigating business opportunities in the U.S. for purposes of deciding whether to enter into a U.S. business generally is not itself a trade or business within the United States.<sup>122</sup>
- Purchasing products in the U.S. for resale abroad, without maintaining a U.S. office, generally does not constitute a trade or business within the United States.<sup>123</sup>
- Acquiring an interest in property in the U.S. from a U.S. person already under contract to purchase that property and participating in the proceeds of its resale abroad does not itself constitute a trade or business within the United States.<sup>124</sup>

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121. Treas. Reg. § 1.864-2(e). *See also* Newman De Vegvar v. Comm'r, 28 T.C. 2055 (1957) (no U.S. business); Chang v. Comm'r, 23 T.C. 1040, 1045 (1955) (no U.S. business); Comm'r v. Nubar, 185 F.2d 584, 588 (4th Cir. 1951) (U.S. business); Adda v. Comm'r, 10 T.C. 273, 279 (1947), *aff'd*, 171 F.2d 457 (4th Cir. 1948) (U.S. business); Adda v. Comm'r, 10 T.C. 1291, 1297 (1948) (U.S. business); Higgins v. Comm'r, 312 U.S. 212, 217-18 (1941), *superseded by statute*, I.R.C. § 212(1) (2008), *as recognized in* Estate of Rockefeller v. Comm'r, 762 F.2d 264, 266 (2d Cir. 1985) (no U.S. business).

122. Abegg v. Comm'r, 50 T.C. 145, 153-54 (1968), *acq.* 1948-2 C.B. 1, *aff'd*, 429 F.2d 1209 (2d Cir. 1970).

123. *See* British Timken, Ltd. v. Comm'r, 12 T.C. 880, 885-87 (1949); European Naval Stores Co., S.A. v. Comm'r, 11 T.C. 127, 132 (1948), *acq.* 1948-2 C.B. 2; Amalgamated Dental Co. v. Comm'r, 6 T.C. 1009, 1014 (1946). One court asserted that, "a decision that activities of this nature are sufficient to [make a foreign taxpayer] . . . engaged in trade or business within the United States would only deter foreign business organizations from purchasing goods in the United States and from engaging the services of banking institutions located in the United States." *United States v. Balanovski*, 131 F. Supp. 898, 903-04 (S.D.N.Y. 1955), *aff'd in part and rev'd in part*, 236 F.2d 298 (2d Cir. 1956).

124. *Pasquel v. Comm'r*, 12 T.C.M. (CCH) 1431 (1953). In *Pasquel*, the property in question was

- Purely promotional activities, such as advertising, gathering and dispersing information, and the use of showrooms, probably do not constitute a trade or business within the United States.<sup>125</sup>
- Direct sale of products to U.S. purchasers, such as via catalogs or the internet, without involvement of a U.S. office or agent, marketing or direct solicitation activity in the U.S., or maintenance of a stock of inventory in the U.S., is not a trade or business within the United States.<sup>126</sup>
- Clerical and ministerial activities, such as the delivery of goods, handling of paperwork, and collection of payments in the U.S. are not enough to amount to the conduct *within the U.S.* of a trade or business.<sup>127</sup>

Even if these U.S. activities are quantitatively substantial, they do not serve to bring a foreign trade or business into the United States. It is worth fleshing out the facts of a couple of the underlying authorities to demonstrate the qualitative nature of these exclusions.

A good illustration is provided by *Spermacet Whaling and Shipping Co. v. Commissioner*.<sup>128</sup> Spermacet was organized under Panamanian law to undertake a whaling expedition on behalf of Smidas Company, Inc., a U.S. corporation that had a contract to sell the resulting oil to ADM, a U.S. corporation.<sup>129</sup> A U.S. officer of ADM was instrumental in organizing Spermacet, in negotiating the acquisition of its ships and the agreements for the sale of the oil, and he acted as its treasurer.<sup>130</sup> Spermacet's organizational meeting was held in New York City, some of its books and records were located in the U.S., and it maintained a New York bank account from which the treasurer disbursed funds.<sup>131</sup> It had no U.S. office as such.<sup>132</sup> The whaling expedition was managed, directed and operated out

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two war surplus landing ships. The transaction in question had more of the indicia of a financing arrangement rather than one of Pasquel purchasing a *bona fide* ownership interest in the ships in question. *Id.* at 1431-32.

125. See Joseph Isenbergh, *The "Trade or Business" of Foreign Taxpayers in the United States*, 61 *Taxes* 972, 979 (1983); 2 Philip F. Postlewaite, *INTERNATIONAL TAXATION: CORPORATE AND INDIVIDUAL* §18.02 (3rd ed. 1998).

126. See *Comm'r v. Piedras Negras Broad. Co.*, 127 F.2d 260, 261 (5th Cir. 1942). While a U.S. office or fixed place of business is not a necessary condition to bring a foreign trade or business into the U.S., the lack of one does make it easier to remain out of the United States. In *Piedras Negras*, the corporation in question was not engaged in a trade or business within the United States because it had no U.S. source income at all. *Id.*

127. *Spermacet Whaling & Shipping Co. v. Comm'r*, 30 T.C. 618, 633-34 (1959), *aff'd*, 281 F.2d 646 (6th Cir. 1960); *Linen Thread Co. v. Comm'r*, 14 T.C. 725, 736-37 (1950).

128. 30 T.C. at 618.

129. *Id.* at 622-23.

130. *Id.* at 619, 623, 626, 629-30.

131. *Id.* at 622, 627-30.

132. *Id.* at 630.



of Norway by Spermacet's Norwegian shareholders, and on the high seas.<sup>133</sup> The oil was delivered to ADM in New York for the account of Smidas, which in turn made payment to Spermacet's New York bank account.<sup>134</sup> Spermacet was not engaged in trade or business within the United States.<sup>135</sup>

*Commissioner v. Piedras Negras Broadcasting Co.*<sup>136</sup> is a particularly good illustration of a qualitative exclusion. Piedras Negras broadcasted programs into the U.S. from a radio station located on the south bank of the Rio Grande.<sup>137</sup> It solicited U.S. advertisers but executed the advertising contracts for its programs in Mexico.<sup>138</sup> It received payment and mail at an accommodation address in Texas, but had no office in the United States.<sup>139</sup> About 95 percent of its advertising revenue was from U.S. persons, and some of its funds were deposited in a U.S. bank.<sup>140</sup> Because its activity in the U.S. was incidental in relation to its overall activity, which generated no U.S. source income, Piedras Negras was not engaged in a trade or business within the United States.<sup>141</sup>

The interaction of *Proposition 3* and *Proposition 5* is that the analysis of whether a foreign trade or business has been brought into the U.S. is *qualitative* and not *quantitative*. Certain *types* of connections are insufficient to bring a foreign trade or business into the United States. Their relative regularity, continuity and considerableness do not affect this determination. One might say that an activity does not serve to bring a foreign trade or business in to the U.S. if it is of a "preparatory or auxiliary character."<sup>142</sup> Activity of such an ancillary nature will not bring a foreign trade or business into the U.S., regardless of how regular, continuous and considerable it is. On the other hand, U.S. activity that is not ancillary will serve to bring a foreign trade or business into the U.S. even if it is sporadic,

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133. *Id.* at 633.

134. *Id.* at 627, 632.

135. *Id.* at 633-34.

136. 127 F.2d 260 (5th Cir. 1942).

137. *Id.* at 260.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.* at 261. The literal application of this decision implies that selling goods or services into the U.S. via the internet is, by itself, qualitatively insufficient to bring a foreign trade or business into the U.S., without regard to whether the quantitative measure of those sales is great or small. A number of proposals that have been advanced with regard to the taxation of electronic commerce imply the modification or abandonment of this *qualitative* standard. See *supra* note 21. Because of this Article's interpretive mission, the policy question of whether to dispose of *Piedras Negras* is beyond its scope.

142. Cf. U.S. Model Income Tax Convention, art. 5, ¶4(e); OECD Model Income Tax Convention, art. 5, ¶4(e). It is true that this model treaty language is not controlling in this context, not only because it is "model" treaty language, but because it addresses the permanent establishment issue and not the Code's conduct of a trade or business within the U.S. issue. Nevertheless, it does provide a helpful articulation of what types of activities are *qualitatively* excluded from bringing a foreign trade or business into the United States.

discontinuous, and minimal.

### C. ILLUSTRATIVE STATUTORY RULES

There are a few of statutory rules that apply to U.S. services in specific contexts. As further outlined *infra*, these specific statutory rules in no way undermine *Proposition 3* that regularity, continuity, and considerableness of U.S. activity are not the test for whether a foreign trade or business has been brought into the United States. Each of these particular-circumstance rules, even the commercial traveler rule, imposes *qualitative* conditions on treatment as the conduct of a trade or business within the United States.

#### i. Commercial Traveler Rule

The performance of personal services within the U.S. by a nonresident alien individual is not the conduct of a trade or business within the U.S. if:<sup>143</sup>

- The individual is temporarily present in the U.S. for periods totaling not more than 90 days during the tax year;
- The aggregate compensation for those services is not more than \$3,000; and
- The individual performs the services either for
  - A nonresident alien individual, foreign partnership, or foreign corporation not engaged in a trade or business within the U.S., or
  - An office or place of business in a foreign country or U.S. possession maintained there by a U.S. citizen or resident, domestic partnership, or domestic corporation.

It is immaterial whether the services performed by the nonresident alien individual are performed as an employee or under any other form of contract with the person for whom the services are performed.<sup>144</sup>

Clearly this exclusion has both quantitative and qualitative aspects. The services must not exceed either 90 days during a tax year or \$3,000 in compensation. At the same time, that aspect is not sufficient to qualify for the exclusion. Even relatively minor services performed by a nonresident alien individual will constitute the conduct of a trade or business within the U.S. if performed for a U.S. office of a U.S. citizen or resident, domestic

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143. I.R.C. § 864(b)(1) (2008).

144. Treas. Reg. § 1.864-2(b)(2)(iii) (2008).

partnership, or domestic corporation.

## ii. Foreign Government Employees

A special rule generally excludes from gross income any wages, fees, or salary of any employee of a foreign government or of an international organization received as compensation for official services to that government or international organization.<sup>145</sup> Strictly speaking this is an exclusion of some amounts from gross income, and it is not an exemption from having a trade or business within the United States. Thus, an individual's other U.S. income, including services income, could well be subject to U.S. net basis taxation,<sup>146</sup> unless some other exemption applies. Nevertheless, it is interesting in this context because this exclusion from U.S. taxation is premised on a set of qualitative requirements and not on any quantitative threshold.

The employee cannot be a U.S. citizen, except that an employee that is a citizen of the Philippines can be a U.S. citizen.<sup>147</sup> In addition, in the case of an employee of a foreign government, both of the following must be true:

- The services must be of a character similar to those performed by employees of the Government of the United States in foreign countries.<sup>148</sup>
- There must be an equivalent exemption granted by the foreign government to employees of the Government of the United States performing similar services in the foreign country.<sup>149</sup>

The State Department certifies to the Treasury the names of the foreign countries that grant an equivalent exemption to the employees of the Government of the United States performing services in those foreign countries. It also certifies the character of the services performed by employees of the Government of the United States in foreign countries.<sup>150</sup>

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145. I.R.C. § 893(a). *See also* Treas. Reg. § 1.893-1. The exemption extends to apply to a consular or other officer, or a nondiplomatic representative. Treas. Reg. § 1.893-1.

146. Treas. Reg. § 1.893-1(a)(3). *See also* Van der Elst v. Comm'r, 223 F.2d 771 (2d Cir. 1955).

147. I.R.C. § 893(a)(1).

148. *Id.* § 893(a)(2).

149. *Id.* § 893(a)(3).

150. *Id.* § 893(b). The exclusion does not apply to either: any employee of a commercial entity controlled by a foreign government, *id.* § 893(c)(1); *see also id.* § 892(a)(2)(B); or any employee of a foreign government whose services are primarily in connection with a foreign government's commercial activity, either inside or outside the United States, *id.* § 893(c)(2).

### iii. Exchange and Training Programs

A nonresident alien individual who is temporarily present within the U.S. under a special visa for an exchange or training program<sup>151</sup> is treated as engaged in a trade or business within the U.S., even if the individual is not otherwise engaged in a trade or business within the United States.<sup>152</sup> Such an individual's U.S. source income from the taxable portion of some kinds of fellowship and scholarship grants, and any taxable reimbursed expenses, are taxed as effectively connected with a trade or business within the U.S., and so are taxed on a net basis.<sup>153</sup>

### D. REAL PROPERTY ACTIVITY—A POTENTIALLY DIFFICULT CASE

Real property activity in the U.S. may or may not constitute the conduct of a trade or business within the United States. It could be a passive investment, which is not a trade or business at all, but it could also be an active business. This is one area in which the factual case-by-case inquiry makes it particularly easy to confuse the question of quality of activity with quantity of activity. It is tempting to confuse the question of active management, which converts passive investment into a trade or business, with a quantity-of-activity analysis. The lack of a clear threshold in the definition of active management makes this especially tempting. In the end, however, the distinction between investment activity and trade or business activity is not the number or extensiveness of real property holdings. Rather, the key question is the qualitative one of whether management of the holdings is active enough to achieve the transition from investment to business.<sup>154</sup>

It is helpful that there are two statutory rules that have the effect of resolving many of the questions in this area. First, under the Foreign Investment in Real Property Tax Act (FIRPTA), gain or loss from the disposition of a U.S. real property interest is treated as if the taxpayer were

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151. 8 U.S.C. § 1101(a)(15)(F), (J), (M), or (Q) (2000).

152. I.R.C. § 871(c).

153. *Id.* §§ 871(c), 1441(b). *See also* Treas. Reg. § 1.871-9 (2008). To the extent that this type of income is subject to withholding at the source, the withholding tax rate is 14 percent and not the usual 30 percent I.R.C. § 1441(a)&(b). Some amounts paid by a foreign employer in connection with temporary presence in the U.S. for exchange or training programs are excluded from gross income entirely. *Id.* § 872(b)(3).

154. *See* Charles D. Rubin & Robert F. Hudson, *Federal Taxation of Foreign Investment in U.S. Real Estate*, Tax Mgmt. Portfolio No. 912, 1996 (presenting an overview of the trade or business question in the real property context).

engaged in a trade or business within the U.S. and as if the gain or loss were effectively connected to it.<sup>155</sup> The implication of FIRPTA is that treatment of U.S. property sales has been resolved.<sup>156</sup> There remains then real property rental activity and mineral working interest income to be resolved on a case-by-case basis.

The second statutory simplification is that foreign taxpayers can elect to treat income from U.S. real estate as trade or business income, if the real estate investments do not otherwise constitute a trade or business within the United States.<sup>157</sup> The general purpose of the election is to permit the real property income to be taxed on a net basis, thereby allowing related deductions to be taken into account, without needing to make a factual determination that the income derives from a trade or business.<sup>158</sup>

In the absence of such an election, real property rental activity can be a passive investment.<sup>159</sup> On the other hand, active management can convert real property rental into a trade or business. For example, U.S. activities (through an agent) of leasing properties, paying operating expenses, taxes, mortgage interest and other necessary obligations, and selling and purchasing U.S. property were sufficient to treat a foreign taxpayer as conducting a trade or business within the U.S.<sup>160</sup> Likewise, executing leases, renting property, collecting rents, keeping books of account, supervising repairs, paying taxes and mortgage interest, insuring property, and purchasing and selling property were sufficient to constitute a trade or business within the U.S.<sup>161</sup>

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155. See I.R.C. § 897(a). For a more extensive discussion of FIRPTA, see Rubin & Hudson, *supra* note 154.

156. FIRPTA's driving purpose was to prevent foreign investments in U.S. real property from escaping U.S. taxation entirely. Nevertheless, it does serve to simplify the question of whether an investment in U.S. real property should be treated as the conduct of a trade or business within the United States. There are authorities relating to the question of whether a person who buys and sells U.S. real property is engaged in a trade or business within the United States. Compare Pinchot, 113 F.2d at 719 with *Investors' Mortgage Sec. Co. v. Comm'r*, 4 T.C.M. (CCH) 45 (1945); *Snell v. Comm'r*, 97 F.2d 891, 893 (5th Cir. 1938). In general, because of FIRPTA, their interest today is for the broader proposition of distinguishing a passive investment from an activity that amounts to a trade or business.

157. I.R.C. §§ 871(d), 882(d).

158. The ALI proposed that all real estate income be taxed on a net basis to eliminate the administrative and compliance burden of making elections. AMERICAN LAW INSTITUTE, FEDERAL INCOME TAX PROJECT: INTERNATIONAL ASPECTS OF UNITED STATES TAXATION 101-02 (1987). The ALI's proposal is presumably premised on a belief that by and large foreign taxpayers would benefit from the net basis election and fail to make it only by mistake. Taxpayers that fail to make the election are subject to a 30 percent tax on their gross real estate income, I.R.C. §§ 871(a), 881(a). Gross basis taxation could easily equate to a confiscatory net-basis tax burden that makes particular real estate investments economically unsustainable.

159. See, e.g., *Herbert v. Comm'r*, 30 T.C. 26, 33 (1958), *acq.* 1958-2 C.B. 6; *Neill v. Comm'r*, 46 B.T.A. 197, 198 (1942); *Rev. Rul.* 73-522, 1973-2 C.B. 226.

160. Pinchot, 113 F.2d at 719.

161. *Lewenhaupt v. Comm'r*, 20 T.C. 151, 162-63 (1953), *aff'd*, 221 F.2d 227 (9th Cir. 1955). See also *De Amodio v. Comm'r*, 34 T.C. 894, 904-05 (1960), *aff'd*, 299 F.2d 623 (3d Cir. 1962); *Investors'*

In the context of domestic taxpayers, an owner that manages even a single property has been considered to conduct a trade or business.<sup>162</sup> If a single rental property can constitute a trade or business entirely on its own, for a foreign taxpayer the issue is not the amount of U.S. property involved. Instead, the distinction is between management of the rental property (even through an agent) versus the holding of U.S. real property purely as an investment. That principle has also been recognized in the international context.<sup>163</sup>

Mineral interests are subject to a similar logic.<sup>164</sup> A right to extract minerals from land is commonly referred to as a "working interest." For example, a lease giving a leaseholder the right to extract oil and gas from land for as long as the land will produce is a "working interest." A working interest is frequently a fractional interest in the mineral extraction rights. A working interest may be a trade or business or a passive investment. To be engaged in a business requires active involvement, directly or through an agent, in the operation of the business.<sup>165</sup> A large enough interest would allow the holder to operate mineral extraction operation indirectly through an operating company and achieve the same result as if the holder operated it directly.<sup>166</sup>

A case in point is *DiPortanova v. United States*.<sup>167</sup> Enrico DiPortanova, a nonresident alien, owned an interest in several trusts that held an oil and gas lease working interest.<sup>168</sup> Collectively among the trusts, the working interest was a 2.27 percent interest in an oil and gas field that was operated by multiple working interest holders as a unit.<sup>169</sup> Quintana Petroleum Corporation, a corporation operated the field for them under an operating agreement that reserved overall supervision and control to the working interest holders acting collectively.<sup>170</sup> Holders with a combined interest of at least 10 percent interest could call a meeting of all of the working interest holders.<sup>171</sup> A 60 percent interest vote was necessary to

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*Mortgage*, 4 T.C.M. (CCH) at 45; *Barbour v. Comm'r*, 3 T.C.M. (CCH) 216 (1944).

162. *Lagreide v. Comm'r*, 23 T.C. 508, 512 (1954) (holding that rental of a single house constituted the conduct of a trade or business, the income of which therefore reduced the taxpayers' net operating loss).

163. *De Amodio*, 34 T.C. at 904-905 (concluding that active management of a single rental property, while pursuing acquisition of others, was sufficient to constitute the conduct of a trade or business within the U.S.).

164. See Rev. Rul. 68-226, 1968-1 C.B. 362 (treating an oil and gas working interest as real property for tax purposes).

165. *DiPortanova v. United States*, 690 F.2d 169, 174 (Ct. Cl. 1982).

166. *Hendrickson v. Comm'r*, 54 T.C.M. (CCH) 1079 (1987). Cf. Rev. Rul. 58-166, 1958-1 C.B. 324.

167. 690 F.2d at 169.

168. *Id.*

169. *Id.* at 174-76.

170. *Id.*

171. *Id.*

remove Quintana, the operator, and a 75 percent interest vote was necessary to decide other issues.<sup>172</sup> Although the trusts' interest gave it the right to participate in operation, it was not enough to constitute active participation in the business.<sup>173</sup> The 2.27 percent interest was a passive investment and not the conduct of a trade or business.<sup>174</sup> Therefore, DiPortanova also was not considered to conduct a trade or business within the United States.<sup>175</sup>

In contrast to a working interest, a royalty interest is a right to oil and gas in place that entitles its owner to a specified fraction, in kind or value, of the total production from the property, free of expense of development and operation. A royalty interest owner is therefore not in the business of producing oil and gas since the owner has neither the right nor the burden of developing and exploiting the property.<sup>176</sup>

### VIII. CONTRARY AUTHORITIES?

A number, but by no means all, of the reported decisions in this area contain language that can be interpreted as examining the quantum of U.S. activity. They refer to a test of the regularity, continuity and considerableness of U.S. activity. If this Article is to fulfill its interpretive mission, it must address these cases.

One potential response would be to assert that, to the extent these authorities hold that a minimum quantum of U.S. activity is a necessary condition to bring a foreign trade or business into the U.S., they are simply wrong. While such an analytical move might have some satisfaction it is not appropriate for this Article, the mission of which is the interpretative assimilation of the existing authorities into a meaningful and useful set of legal standards. Moreover, this Article does not reject a quantitative analysis per se. *Proposition 2* validates a quantitative analysis, because regularity, continuity, and considerableness of U.S. activity can be sufficient to establish the conduct of a U.S. trade or business. On the other hand, *Proposition 3* asserts that there is no minimum quantum of U.S. activity necessary to bring a foreign trade or business into the United States. A necessary task for this Article, therefore, is to reconcile *Proposition 3* with the existence of authorities that assert that both a quantitative and a qualitative threshold must be satisfied in all cases.

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172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. Rev. Rul. 69-355, 1969-1 C.B. 65.

## A. CASE-BY-CASE FACTUAL DISTINCTIONS

One approach to this problem is to examine the cases individually in light of their particular factual circumstances. Regardless of what a court actually asserts it is deciding, it is axiomatic that it has only the authority to decide “the particular dispute which is before it . . . [and] everything . . . in an opinion, is to be read with primary reference to the particular dispute . . . .”<sup>177</sup> One is hard-pressed to find a case asserting a predicate of some minimum quantitative threshold of U.S. activity in which that assertion was actually necessary to resolve the factual situation presented.

An individual examination of commonly cited cases is instructive. Based on the factual circumstances actually presented, these courts had no need to establish a legal principle that negates the principle expressed in this Article by *Proposition 3*. In that sense, to the extent that they assert, or can be interpreted as asserting, that some minimum quantum of U.S. activity is necessary to bring a foreign trade or business into the U.S., those assertions are dicta.

Some cases that can be cited because they refer explicitly to regularity, continuity and considerableness in their analysis also conclude that a trade or business within the U.S. exists based solely on the foreign taxpayer’s U.S. activities. They find a U.S. trade or business while disregarding the taxpayer’s foreign activities entirely.<sup>178</sup> Therefore, regardless of language they use to the contrary, they do not resolve the analytical problem of a foreign taxpayer that engages in some trade or business somewhere in the world, but the U.S. activities of which are not sufficient in themselves to constitute a trade or business.

Some cases refer to a quantitative test, but find that no trade or business was conducted within the U.S. because the U.S. connections were for investment and not for business.<sup>179</sup> Revenue Ruling 73-522<sup>180</sup> illustrates this phenomenon. The taxpayer was a nonresident alien individual.<sup>181</sup> During 1971, the only activity in the U.S. in which the taxpayer engaged was as described here. The taxpayer owned rental property situated in the

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177. KARL N. LLEWELLYN, *BRAMBLE BUSH* 42-43 (Oceana ed. 1978) (emphasis omitted).

178. See, e.g., *Pinchot*, 113 F.2d at 718; *De Amodio v. Comm’r*, 34 T.C. 894 (1960); *Lewenhaupt*, 20 T.C. at 151 (1953); *Perez v. Comm’r*, 56 T.C.M. (CCH) 312 (1988); see also *supra* notes 56-72 and accompanying text. Strictly speaking, *Perez* states that, “A foreign taxpayer is engaged in a trade or business within the United States if the taxpayer, continuously and regularly, transacts a substantial portion of its ordinary business within the United States during a substantial portion of the taxable year.” 56 T.C.M. (CCH) at 317. It does not assert that they are a necessary condition.

179. See, e.g., *Herbert*, 30 T.C. at 33.

180. 1973-2 C.B. 226.

181. The taxpayer did not elect to treat real property income as income effectively connected with the conduct of a trade or business within the United States. See I.R.C. § 871(d) (2008).



U.S. that was subject to long-term leases.<sup>182</sup> Each lease provided for a minimum monthly rental and the payment by the lessee of real estate taxes, operating expenses, ground rent, repairs, interest and principal on existing mortgages, and insurance in connection with the property leased.<sup>183</sup> The leases were referred to as "net leases" and were entered into by the taxpayer on December 1, 1971.<sup>184</sup> The taxpayer visited the U.S. for approximately one week during November of 1971 for the purpose of supervising new leasing negotiations, attending conferences, making phone calls, drafting documents, and making significant decisions with respect to the leases.<sup>185</sup> This was the taxpayer's only visit to the U.S. during 1971.<sup>186</sup> The leases were identical in form (net leases) to those applicable to the properties owned by the taxpayer before December 1, 1971.<sup>187</sup> The lessees were unrelated to each other or to the taxpayer.<sup>188</sup> The negotiation of new leases in the U.S. did not transform this investment from a passive investment into a trade or business.<sup>189</sup> The taxpayer was not considered to conduct a trade or business within the U.S. during the taxable year ended December 31, 1971.<sup>190</sup>

The Service's analysis asserts that the November 1971 trip to the U.S. did not bring the trade or business into the U.S. because it was sporadic, irregular, and minimal.<sup>191</sup> This quantitative analysis, however, is unnecessary and beside the point. The investments described in the revenue ruling were net leases in which the lessee took on all of the responsibilities otherwise the responsibility of active management. In short, the investments were purely passive investments to the lessor. In November 1971, the taxpayer acquired additional such passive investments. A qualitative analysis excludes this investment activity from counting toward the conduct of a trade or business within the United States. That makes the quantitative analysis unnecessary.

Another good illustration is Continental Trading, Inc., which existed for the purpose of managing an investment portfolio for Axel Werner-Gren.<sup>192</sup> That activity clearly was not the conduct of a trade or business.<sup>193</sup> Its only non-investment activity, anywhere in the world, was also insufficient to constitute any trade or business.

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182. Rev. Rul. 73-522, 1973-2 C.B. 226.

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Cont'l Trading, Inc. v. Comm'r*, 265 F.2d 40, 40-44 (9th Cir. 1959).

193. *See supra* notes 111-121 and accompanying text.

Its non-investment activities were a very small number of "isolated and noncontinuous" transactions.<sup>194</sup> These transactions were more related to the separate business of Grover Turnbow, who was also Continental's president, than they were to Continental's investment portfolio.

These were of three kinds: (1) In July, 1948, . . . [Continental] purchased a carload of dry milk fat from Kraft Foods Company for \$46,212.75 and sold it one month later through one of Turnbow's companies for \$40,248. (2) As an accommodation to a Mexican corporation . . . [it] purchased, in 1950, equipment for that corporation for which it was reimbursed without profit. (3) In all three years [under consideration,] . . . [it] bought tin cans for milk products which were needed by . . . one of Turnbow's companies. . . . [Only] nominal amounts of income result[ed] from transactions relating to cans used by [Turnbow's company] . . . . In 1948, such reported income amounted to \$120.64; in 1949, \$3,509.90; in 1950, \$5,239.19. . . . There was no business purpose connected with the can transactions engaged in by [Continental] . . . . It never used its Nevada office in these operations. It carried no inventory of cans and ordered no cans other than those . . . .<sup>195</sup>

These were Continental's only non-investment transactions anywhere in the world.<sup>196</sup> In contrast, during those same years Continental's gross income, overwhelmingly from investment activities, was \$817,791.39 for 1948, \$605,635.10 for 1949, and \$446,863.19 for 1950.<sup>197</sup>

The regularity, continuity, and considerableness of Continental's non-investment activities was pertinent to determining whether it was engaged in a trade or business at all anywhere in the world.<sup>198</sup> It was not so engaged. Thus, the resolution of this case provides no support for a claim that the quantity of U.S. activity is relevant in determining whether an admitted foreign trade or business is being conducted within the United States. Continental was not engaged in a trade or business anywhere in the world, therefore, it could not be engaged in a trade or business within the United States.

Other commonly cited cases refer to a minimum quantitative threshold of U.S. activities and find that it is satisfied. Nevertheless, they conclude, on qualitative grounds, that the U.S. activities do not constitute the conduct of a trade or business within the United States.<sup>199</sup> These cases also do not

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194. *Cont'l Trading*, 265 F.2d at 44.

195. *Id.* (footnote and internal quotation marks omitted).

196. *Cont'l Trading, Inc. v. Comm'r*, 16 T.C.M. (CCH) 724 (1957), *aff'd*, 265 F.2d 40 (9th Cir. 1959).

197. *Cont'l Trading*, 265 F.2d at 42.

198. *Id.* at 45.

199. *Scottish Am. Inv. Co. v. Comm'r*, 12 T.C. 49, 58-60 (1949); *Spermacet*, 30 T.C. 633-34; *European Naval Stores*, 11 T.C. at 132.

establish a minimum quantum of U.S. activity to bring a foreign trade or business into the U.S., because their assertions of a quantitative threshold are dicta.

*Linen Thread v. Commissioner*<sup>200</sup> provides a good example of how a qualitative exclusion implies that reference to a quantitative threshold is dicta. The taxpayer had an agent at an office in the United States. Aside from investment related activities, the agent's tasks were limited to investigating and reporting on new fibers and maintaining a set of books.<sup>201</sup> The taxpayer's remaining connections to the United States were two sales of merchandise to U.S. persons.<sup>202</sup> Those sales, however, were consummated directly into the U.S. from Scotland without the involvement of a U.S. office or agent.<sup>203</sup> The taxpayer's U.S. office played no role in the solicitation or consummation of the sales, or any other sales.<sup>204</sup> It performed only clerical acts limited to the delivery of goods, handling of paperwork, and collection of payments.<sup>205</sup> Thus, the U.S. activities were only clerical and ancillary in nature.<sup>206</sup> An examination of their extensiveness or of the numerosity of the transactions to which they were related is immaterial, and the court's reference to the test being both quantitative and qualitative<sup>207</sup> is dicta.

The two cases that come nearest to actually depending for their dispositions on a minimum quantitative threshold are *European Naval Stores Co., S.A. v. Commissioner*<sup>208</sup> and *Pasquel v. Commissioner*.<sup>209</sup> In the end, however, a minimum quantum of U.S. activity—regularity, continuity, and considerableness—is not actually necessary to the resolution of either.

Jorge Pasquel, a nonresident alien individual, acquired a partial interest in two war surplus landing ships from a corporation, Higgins, Inc., that was already under contract to purchase the ships from the U.S. government.<sup>210</sup> Pasquel shared in the proceeds of the sale of the ships to the Government of Argentina.<sup>211</sup> He entered into the transaction entirely from Mexico and, aside from this transaction, had no other economic connection to the United States.<sup>212</sup> This decision is explained simply on the principle that the purchase of property in the U.S. for resale abroad is not sufficient

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200. 14 T.C. 725 (1950).

201. *Id.* at 725-30.

202. *Id.* at 735-36.

203. *Id.*

204. *Id.*

205. *Id.*

206. *Id.* at 734-36.

207. *Id.* at 736.

208. 11 T.C. 127 (1948), *acq.* 1948-2 C.B. 2.

209. 12 T.C.M. (CCH) 1431 (1953).

210. *Id.*

211. 12 T.C.M. (CCH) at 1431.

212. *Id.*

by itself to bring such a foreign taxpayer's foreign trade or business into the United States, without regard to the extent of the U.S. purchases.<sup>213</sup>

In the alternative, the interest in question could easily be classified as a security interest in respect of a loan. The taxpayer was given oral assurance by Higgins, Inc., that he would suffer no loss in the transaction.<sup>214</sup> In addition, a chattel mortgage was made for the protection of the taxpayer's investment.<sup>215</sup> Last, relative to Higgins, Inc., the taxpayer enjoyed priority in receipt of the ultimate sales price.<sup>216</sup> Under this reading, the taxpayer made a loan<sup>217</sup> that amounted to a passive investment position, and investment activity does not itself cause a foreign person to conduct a trade or business within the United States.<sup>218</sup>

European Naval Stores Co., S.A., a Belgian corporation, purchased certain goods in the U.S. for resale abroad but they proved undeliverable because of World War II and were deteriorating while sitting in the U.S. warehouse.<sup>219</sup> The U.S. seller, Peninsular-Lurton Co., unilaterally repurchased the goods, without the knowledge or consent of the foreign purchaser.<sup>220</sup> The U.S. seller did so at the then-current market price, crediting a profit to the foreign purchaser.<sup>221</sup> The foreign purchaser was not thereby engaged in a trade or business within the United States.

Notwithstanding the court's protestations to the contrary,<sup>222</sup> it does seem crucial to this decision that the sale in the U.S. was unplanned and compelled by the *force majeure* of the World War II. A telling aspect of this decision is the allusion to an unpressed transfer pricing issue.<sup>223</sup> European Naval Stores and Peninsular-Lurton were conceded to be under common control.<sup>224</sup> The repurchase at then-current market prices generated a profit for European Naval Stores that was not taxable unless it was treated as engaged in a trade or business within the United States. The related U.S. corporation no doubt recognized an equal loss. If the repurchase had been

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213. See *British Timken, Ltd. v. Comm'r*, 12 T.C. 880 (1949); *Amalgamated Dental Co. v. Comm'r*, 6 T.C. 1009, 1014 (1946).

214. *Pasquel*, 12 T.C.M. (CCH) at 1431

215. *Id.*

216. *Id.* at 1432.

217. *Id.* at 1432-33.

218. See *supra* notes 111-121 and accompanying text. In addition, in *Pasquel* the Tax Court's factual presentation focuses on the single transaction and does not indicate whether the taxpayer was engaged in a trade or business outside the United States. *Pasquel*, 12 T.C.M. (CCH) at 1431-32. If he was not engaged in a trade or business on a worldwide basis, he could not have been engaged in a trade or business within the United States. Nevertheless, this is speculative given the available factual record.

219. *European Naval Stores*, 11 T.C. at 129-30.

220. *Id.* at 132

221. *Id.* at 128-31.

222. *Id.* at 133, 135.

223. See Internal Revenue Code of 1939 § 45. For the text of the provision, which is continued in the currently applicable law as I.R.C. § 482 (2008), see Pub. L. 76-1, 53 Stat. 1, 25 (1939).

224. *European Naval Stores*, 11 T.C. at 134.

at a price no higher than the original sale, there would not have been any such pairing of a U.S. loss and a foreign related-party gain. In that sense, there would have been no particularly good reason for the Service to pursue the trade or business issue.

A rational and informed taxpayer would seriously hesitate to use *Pasquel* or *European Naval Stores* as authority to plan to purchase and resell even small amounts of goods in the U.S. and claim not to conduct a trade or business within the United States. It is not surprising to find qualitative exclusions in cases with minimal quantity of connection. A taxpayer would be foolish to rely exclusively on *de minimis* contact to avoid U.S. conduct of a trade or business, given the authorities finding such conduct with minimal conduct. Likewise, the Service's own rulings on the sufficiency of minimal contact counsel it to have a qualitative argument available. The crucial comparison is that there are authorities using qualitative grounds to find no U.S. conduct of a trade or business notwithstanding large numbers of transactions but there are also authorities finding in favor of such conduct with minimal U.S. transactions. That observation indicates that it is the qualitative, not the quantitative, issue that is controlling, which makes the quantitative issue dispensable in deciding whether a foreign trade or business has been brought into the United States.

## B. CASES VIEWED JOINTLY

While each of these authorities can be distinguished on its facts in a way that makes a contradiction of *Proposition 3* dicta, the number of these cases does make something of an impression on its own. This suggests an examination of this body of cases as a whole to consider the origin of these assertions of a predicate minimum quantitative threshold, viewed purely as assertions and not as essential elements to the resolution of actual cases.<sup>225</sup> Can that origin be explained in ways that preserve the validity of *Proposition 3*, notwithstanding assertions seemingly to the contrary?

With very few exceptions,<sup>226</sup> the authorities give no indication at all as to why they articulate regular, considerable, and continuous U.S. activity as a predicate threshold. A real possibility is that the references to quantity—to regularity, continuity, and considerableness—of activity were based on

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225. A further consideration is the difficulty of proving the non-existence of other cases. A diligent search sought every decision articulating a minimum quantitative threshold—that is, regularity, continuity, and considerableness—for finding the conduct of a trade or business within the United States. Nevertheless, it is difficult to prove that no other cases exist. This in itself counsels a consideration of these cases as a body, rather than relying solely upon the case-by-case distinguishing analysis.

226. See *infra* note 256 and accompanying text.

an unconsidered and unnecessary mimicking of the standard applied in the purely domestic context. An articulation of the standard was needed, and courts, focusing on the expression “trade or business” rather than the foreign taxpayer context in which it appeared, simply copied the standard from the domestic context without any particular justification for so doing.<sup>227</sup> Once that standard had been transposed in this manner to the international context, it became the path of least resistance to repeat it reflexively without consideration of any justification.

Nevertheless, as the case-by-case distinguishing analysis demonstrates,<sup>228</sup> there are a number of reasons why conflating the domestic and international contexts did no harm in the sense that it did not affect the cases’ dispositions. A taxpayer might not engage in a trade or business anywhere in the world,<sup>229</sup> or its U.S. activities might be sufficient in themselves to constitute a trade or business.<sup>230</sup> In either circumstance, no harm was done because the problem of bringing a foreign trade or business into the U.S. was not presented. Another possibility was that none of the taxpayer’s U.S. activities “counted” in the determination.<sup>231</sup> Qualitative grounds caused the U.S. activities to be set aside, which in turn set the quantity of U.S. activity measurement to zero, thereby mooted the issue of a minimum quantitative threshold.

This pattern of cases presents a marvelous illustration of Karl Llewellyn’s classic explanation of the necessity of a concept of dicta in the common law system. Presented with the need to dispose of a single case with a limited set of facts in a timely manner, a court seeks an articulation of a neutral principle to apply. In those circumstances, it adopts an articulation that is overly broad in the sense that, taken literally, it resolves a swathe of cases not actually presented or considered. The risk of this type of overstatement is accentuated when the articulation is adopted wholesale from another area without an opportunity to consider carefully whether that is appropriate. It is only later factual scenarios that demonstrate its excessive breadth. Fortunately, *stare decisis* does not make

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227. See *Pinchot*, 113 F.2d at 718; *Linen Thread Co. v. Comm’r*, 14 T.C. at 725; *European Naval Stores*, 11 T.C. at 132; *Cont’l Trading*, 16 T.C.M. (CCH) 724. In the earliest of these cases, *Pinchot*, not only was the domestic standard imported into the international context, it was also imported from the income tax context to the estate tax context. In that sense, it was a doubly unconsidered adoption of a standard from another context.

228. See *supra* notes 177-222 and accompanying text.

229. See, e.g., *Cont’l Trading*, 16 T.C.M. (CCH) at 724.

230. See, e.g., *Pinchot*, 113 F.2d at 718; *De Amodio v. Comm’r*, 34 T.C. 894 (1960); *Lewenhaupt v. Comm’r*, 20 T.C. at 151; *Perez v. Comm’r*, 56 T.C.M. (CCH) 312 (1988).

231. It is possible to exclude all of the U.S. activity on account of being investment activity, see, e.g., *Herbert*, 30 T.C. at 33-34; *Pasquel v. Comm’r*, 12 T.C.M. (CCH) 1431 (1953), or some other form of ancillary activity, see, e.g., *Spermacet*, 30 T.C. at 633-34; *European Naval Stores*, 11 T.C. at 132; *Pasquel*, 12 T.C.M. (CCH) at 1431, or a combination of the two, see, e.g., *Linen Thread*, 14 T.C. at 730-31.

it inevitable that overly broad statements control those later cases.<sup>232</sup>

Even in the absence of an express justification, however, there may be some unstated justification of the form of the standard's articulation. One possibility is that imposing net basis taxation on foreign taxpayers whose U.S. economic connections do not reach a minimum quantitative threshold imposes unjustifiable administration and compliance costs on the Service and foreign taxpayers respectively. Therefore, according to the argument, the minimum quantitative threshold served—and does serve—to mitigate the imposition of administrative and compliance costs that are out of proportion to the amount of tax at stake.<sup>233</sup> Viewed from a policy perspective, this line of reasoning certainly holds some attraction. This Article does not dispute that administrability and compliance issues could well caution such a quantitative threshold.

This Article's mission, however, is interpretive. The question is whether the minimum quantitative threshold, as the existing authorities articulate it and placing those articulations in their contextual environment, can be convincingly rationalized by solicitude for administrability and compliance issues. Those authorities articulate a predicate threshold that U.S. activities must be regular, continuous, and considerable in all cases, but give no real guidance as to how much activity is necessary to satisfy that criteria. The environment in which that articulation subsists is one in which some relatively minor U.S. connections have been sufficient to bring a foreign trade or business into the U.S.,<sup>234</sup> but fairly regular, continuous, and considerable activity has frequently not been sufficient because it was investment activity or was in some other sense ancillary, clerical, or ministerial.<sup>235</sup> Viewed as a matter of interpretation—rather than efficacious policy—administrative and compliance concerns do not justify a minimum

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232. LLEWELLYN, *supra* note 177, at 43-45. As Professor Llewellyn explained:

You reach, at random if hurried, more carefully if not, for a foundation, for a major premise. But never for itself. Its interest lies in leading to the conclusion you are headed for. You shape its words, its content, to an end decreed. More, with your mind upon your object you use words, you bring in illustrations, you deploy and advance and concentrate again. When you have done, you have said much you did not mean. You did not mean, that is, *except* in reference to your point.

*Id.* at 45.

233. It is worth noting that, in this context, solicitude for taxpayers would be directed primarily toward the burdens of complying with the tax and not with the burden of paying the tax. The effectively connected concept is the primary mechanism for defining and limiting the extent of the U.S. tax burden for foreign taxpayers engaged in low levels of trade or business within the United States. It ensures, to the extent that it fulfills its function, that the U.S. tax burden is not excessive in comparison to the extent of U.S. business activity. See *supra* notes 102-110 and accompanying text. Thus, the concept of trade or business within the U.S. could not be the primary protection against disproportionate tax burden.

234. See *supra* notes 78-101 and accompanying text.

235. See *supra* notes 111-142 and accompanying text.

quantitative threshold for the conduct of a trade or business within the United States, at least not as it has been enunciated over the years.

From the tax administration perspective, an office or fixed place of business standard could significantly mitigate the burden imposed upon the Service. In the absence of such a standard, however, a generalized minimum quantitative threshold theory, with no guidance as to what is the minimum quantum, does nothing to reduce the Service's administrative burden. It remains obliged to consider each taxable year of each taxpayer on a factual case-by-case basis.<sup>236</sup> It has the same burden of deciding whether the burden of enforcement action is justifiable in each case, with or without an undefined minimum quantitative threshold. The addition of such a legal standard adds nothing meaningful to the Service's existing ability to minimize wasted administrative costs via its discretion in bringing enforcement actions.<sup>237</sup> This is not to deny that a more coherent standard—such as an “office or fixed place of business” standard—might be justifiable as a matter of policy. Such a standard could ease enforcement by creating a bright line, or at least a brighter line.<sup>238</sup> Nevertheless, as a matter of interpretation, the minimum quantum formulation as it has been expressed advances no meaningful administrability concern.

A similar analysis applies in viewing taxpayer compliance burdens. As a policy matter, there is more than a little justification in allowing a threshold below which the compliance costs of net basis taxation are not imposed. Once again, an office or fixed place of business standard is one candidate that comes to mind as a kind of safe harbor.<sup>239</sup>

There is nothing of a safe harbor, however, in a generalized minimum quantitative threshold that provides no guidance as to what is the minimum quantum, and exists simultaneously with a qualitative threshold. As

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236. Treas. Reg. § 1.864-2(e) (2008). See also Rev. Rul. 88-3, 1988-1 C.B. 268.

237. The need to maintain administrative flexibility undoubtedly figures significantly in the Service's reluctance to issue a ruling on whether a foreign taxpayer is engaged in a trade or business within the United States. See Rev. Proc. 2007-7, 2007-1 I.R.B. 227. The list of areas in which the Service will not issue rulings is renewed annually in a revenue procedure published in the first Internal Revenue Bulletin of the year.

238. It does appear in practice that the permanent establishment concept does deal with administrability in a manner that the trade or business within the U.S. standard does not address it. For example, a foreign individual that owned and operated a foreign racehorse stable brought a single racehorse into the U.S. to participate in a single race. The Service concluded that participation in that one race was sufficient to constitute the conduct *in the U.S.* of a trade or business. However, it also indicated that the taxpayer would be permitted to establish the absence of a permanent establishment by providing definite information of having no intention of entering a horse in a second race during the same taxable year. Rev. Rul. 58-63, 1958-1 C.B. 624, *amplified in* Rev. Rul. 60-249, 1960-2 C.B. 264.

239. Another conceivable form of taxpayer-friendly safe harbor might be to eliminate the return filing obligation, see I.R.C. § 6012 (2008), below some threshold level of income subject to U.S. net basis taxation.



described *supra*, the decided cases provide no reliable guidance as to how much U.S. activity exceeds the supposed threshold. As enunciated, a quantitative theory creates uncertainty as to whether taxpayers have incurred U.S. net-basis compliance obligations. Moreover, imposing two standards simultaneously—here both quantitative and qualitative—serves to increase uncertainty of classification not to decrease it.<sup>240</sup> Once again, whatever might be justifiable from a policy perspective, from an interpretive perspective solicitude about taxpayers' compliance obligations cannot justify the existing formulations of a minimum quantitative threshold.<sup>241</sup>

In no way does this argument deny that Congress certainly could impose a minimum quantitative threshold.<sup>242</sup> The argument is solely that administrative and compliance issues are unsustainable as justifications for interpreting the historic, and existing, Code provisions as imposing the undefined minimum quantitative threshold as it has been expressed in case law.

### C. HISTORICALLY CONTEXTUAL VIEW

Another possible justification of these articulations of the standard, even when viewed purely as dicta, is that, at the time, they served to discourage or mitigate a perceived problem of foreign taxpayer manipulation to gain unintended benefits of net basis taxation. An historically contextual view of the cases presents a good case for such an explanation of the manner in which the standard was articulated. Nevertheless, that concern was predicated on the state of the Code at that time. Later amendments to the Code have obviated that justification. As a

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240. Cf. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 103 (1942), reprinted in J.S. SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAW 1953-1939 1877 (1954) (arguing that using two different tests for imposition of net basis taxation increases uncertainty unnecessarily, which was one justification for eliminating one of them via the Revenue Act of 1942).

241. If a particular taxpayer did avoid U.S. taxation based on some minimum quantitative threshold, it would certainly be pleased. Nevertheless, the standard is not predictable enough to allow a foreign taxpayer to rely *ex ante* exclusively on a quantitative analysis. It is hard to see the unreliable prospect of saving some tax as well as the cost of compliance as a justification for a minimum quantitative threshold, at least not using the unpredictable articulation it has taken.

242. An argument that this Article does not raise is one premised on what Congress could have done but did not. It is true that if Congress were concerned about administrative or compliance issues it could have adopted an office or fixed place of business predicate or it could have adopted the effectively connected concept much sooner than it actually did. That it did not do so would not necessarily have deterred courts from finding a corrective to those concerns via interpretation. In that vein, taxpayer manipulation concerns are discussed *infra*, see notes 243-264 and accompanying text. Congress could equally have addressed this taxpayer manipulation concern. That it did not do so could well have been argued as a justification for not intervening judicially, but in practice it does not appear to have prevented that intervention.

result, it is no longer controlling.

Of particular importance is the history of the evolution in foreign taxpayers' access to net basis taxation. A foreign taxpayer subject to gross basis taxation loses the tax benefit of any deductions or credits that would properly be allocated and apportioned to that U.S. source gross income. Many foreign taxpayers with significant U.S. source passive investment income could significantly reduce their U.S. tax liability if they could arrange to bring it within the net basis tax regime. Before 1936, this was a fairly simple question. Foreign taxpayers not otherwise subject to U.S. net basis taxation were permitted functionally to elect it for all of their U.S. source income simply by filing a tax return.<sup>243</sup>

In 1936, however, net basis taxation became applicable only to foreign taxpayers that either engaged in a trade or business within the U.S. or had a U.S. office or place of business.<sup>244</sup> The interaction of that provision and the force of attraction principle resulted in a substantial tax planning opportunity. If a foreign taxpayer qualified at all for net basis taxation, then the force of attraction principle caused all of its U.S. source income to receive net basis taxation and, therefore, reduction by appropriate deductions.<sup>245</sup> Access to the dividends received deduction<sup>246</sup> was particularly significant to foreign corporations that were substantial holders of the stock of domestic corporations.

On the other hand, this interaction of net basis taxation and the force of attraction principle was foreclosed to a foreign taxpayer that neither conducted a trade or business within the U.S. nor maintained a U.S. office or place of business. For the tax years before 1942, minimally establishing one of those two was the plan of many foreign taxpayers. The path of least resistance for many was to assert the existence of a U.S. office with the most minimal factual foundation defensible.<sup>247</sup>

The Revenue Act of 1942 deleted the references to "an office or place of business" from the pertinent provisions of the Code.<sup>248</sup> Concern about manipulative technical planning to achieve the benefits of net basis taxation

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243. See Kaufman, *supra* note 12, at 765-67.

244. Revenue Act of 1936, Pub. L. 74-740, ch. 690, §§ 211, 231, 49 Stat. 1648, 1714-15, 1717 (1935-36). See also Internal Revenue Code of 1939 §§ 211, 231. For the text of these latter provisions, see Pub. L. 76-1, 53 Stat. 1, 75-76, 78 (1939).

245. See S. REP. NO. 89-1707 (1966), reprinted in 1966 U.S.C.C.A.N. 4446, 4462-63, 4477-78 (explaining force of attraction principle). See also 2 Philip F. Postlewaite, INTERNATIONAL TAXATION: CORPORATE AND INDIVIDUAL § 19.11 (3d ed. 1998).

246. Revenue Act of 1936, Pub. L. 74-740, ch. 690, §§ 26(b), 119(b), 232(a), 49 Stat. 1648, 1664, 1694, 1717 (1935-36).

247. See, e.g., *The Scottish Am. Inv. Co., Ltd., v. Comm'r*, 47 B.T.A. 474 (1942), *aff'd*, 139 F.2d 419 (4th Cir. 1943), *aff'd*, 323 U.S. 119 (1944); *Aktiebolaget Separator v. Comm'r*, 45 B.T.A. 243 (1941); *Recherches Industrielles, S.A., R.I.S.A. v. Comm'r*, 45 B.T.A. 253 (1941).

248. Revenue Act of 1942, Pub. L. 77-753, ch. 619, § 160(d), 56 Stat. 798, 861 (1942).

was prominent in the House Ways and Means Committee's recommendation of the change.

A tendency has arisen, principally on the part of foreign corporations which are substantial holders of the stock of domestic corporations and, occasionally on the part of nonresident alien individuals, to attempt to establish that they have an "office or place of business" within the United States and hence secure the very different tax treatment accorded taxpayers . . . [having an office or place of business therein]. Since such corporations and individuals engage in no other economic activities in the United States, they cannot be said to be engaged in trade or business within the United States.

It appears to your committee to be in the interests of good administration to establish but one test . . . in ascertaining the classification of foreign entities, namely, whether or not it is engaged in trade or business within the United States. Such amendment narrows sharply the field of uncertainty arising in such cases and removes a possible avenue of tax avoidance to large foreign, corporate and other holders of domestic securities.<sup>249</sup>

As a result of this amendment, for taxable years beginning after December 31, 1941,<sup>250</sup> net basis taxation applied only to taxpayers that conducted a trade or business within the United States. On the other hand, if the taxpayer did conduct a trade or business within the U.S., the force of attraction principle continued to apply. Thus, its U.S. source passive income became eligible for net basis taxation and the tax benefits of taking deductions. Minimal qualification as conducting a trade or business within the U.S. could be a significant tax benefit and became even more important to foreign taxpayers than it was before the 1942 legislation.

The Foreign Investors Tax Act of 1966<sup>251</sup> changed this tax planning landscape. It replaced the force of attraction principle with a regime in which net basis taxation applies to income only to the extent that it is effectively connected with the conduct of a trade or business within the United States.<sup>252</sup> For taxable years beginning after December 31, 1966,<sup>253</sup> U.S. source passive income is drawn into net basis taxation only if there is a factually based connection between the investment income and the

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249. H.R. REP. NO. 2333, 77th Cong., 2d Sess. 103 (1942), *reprinted in* J.S. SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAW 1953-1939 1877 (1954). *See also* J.S. SEIDMAN, LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAW, at 1877-88 (*reprinting* S. REP. NO. 1631, 77th Cong., 2d Sess. 135-36 (1942)).

250. Revenue Act of 1942, Pub. L. 77-753, ch. 619, § 101, 56 Stat. 798, 802.

251. Pub. L. 89-809, 80 Stat. 1539 (1966).

252. Pub. L. 89-809, §§ 103(a), 104(b), 80 Stat. 1539, 1547-50 & 1555-57 (1966). *See also* Pub. L. 89-809, § 102(d), 80 Stat. 1539, 1544-47 (1966) (adopting I.R.C. § 864(c) definition of effectively connected income).

253. Pub. L. 89-809, §§ 102(e), 103(n)(1), 104(n), 80 Stat. 1539, 1547, 1555, 1563 (1966).

taxpayer's conduct of a trade or business within the United States.<sup>254</sup> After 1966, qualification as conducting a trade or business within the U.S. no longer had the potential to bring the significant tax benefits that it had for the previous generation.

Thus, there was a crucial thirty-one-year period, from 1936 through 1966, in which minimal qualification as conducting a trade or business within the U.S. served to convert the gross basis taxation of all passive investment income into frequently valuable net basis taxation.<sup>255</sup> Courts and the I.R.S. may very well have been concerned about what they perceived as manipulation of this standard to gain a tax windfall. It is crucial to note here that the perceived windfall arose from the interaction of the trade or business standard with the force of attraction principle. The two principles applied integrally, and therefore the interpretation of the former is also simultaneously the interpretation of the latter.

Courts might well have decided to take it upon themselves to fix this problem. Assertions of a minimum quantum of U.S. activity, even when not necessary to resolve the actual cases presented, may have seemed desirable to serve the prophylactic purpose of deterring bad faith attempts to gain the benefit of using the force of attraction principle as a means of applying net basis taxation to passive investment income. Among reported decisions treating taxable years in the crucial period of 1936 through 1966, only two delve at all into what role an inquiry into trade or business within the U.S. serves. Notably, both of these use the Revenue Act of 1942 and committee reports accompanying it to conclude that the test prevents foreign taxpayers from gaining inappropriate access to deductions against investment income.<sup>256</sup>

After 1966, there no longer was any need to police the trade or business standard as a means of limiting access to net basis taxation for passive investment income. At this late date, no one can assert with any authority how these courts would have interpreted the "trade or business within the U.S." standard if Congress had adopted the effectively connected income rules in 1936 at the same time that it eliminated the privilege of electing net basis taxation for passive investment income. One can say, however, that assertions in dicta of a minimum quantitative threshold are the product of the joint interpretation of the "trade or business within the U.S." standard and the force of attraction principle in a regime in which net basis taxation was no longer to be elective for passive investment income.

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254 I.R.C. §§ 864(c), 871(b), 882 (2008).

255. See, e.g., *Amalgamated Dental Co. v. Comm'r*, 6 T.C. 19 (1946); *Scottish Am. Inv. Co. v. Comm'r*, 12 T.C. 49 (1949); *Linen Thread Co*, 14 T.C. at 725; *Cont'l Trading*, 16 T.C.M. (CCH) at 724.

256. *Cont'l Trading*, 16 T.C.M. (CCH) at 724; *Scottish Am.*, 12 T.C. at 49.

The Foreign Investors Tax Act of 1966 crucially amended the statutory landscape. Decisions for taxable years from 1936 through 1966 interpreted the prior statutory landscape. As previously observed, it is axiomatic that a court has only the authority to decide "the particular dispute which is before it . . . [and] everything . . . in an opinion, is to be read with primary reference to the particular dispute . . . ."<sup>257</sup> The pre-1967 statutory landscape was integral to those decisions. Its passing means that, even if the pertinent assertions weren't dicta, *stare decisis* certainly would not apply to have the prior-law cases control the interpretation of the post-1966 statutory terrain.

An objection to this line of reasoning bears anticipation. The Foreign Investors Tax Act of 1966 did not adopt a comprehensive definition of what it means to "conduct a trade or business within the United States." It did make some minor amendments to the guidance that Code does provide on the meaning of that term,<sup>258</sup> but those amendments did not address the core meaning of the term or refer to a quantitative threshold. The amendment on which this line of reasoning depends was the adoption of the "effectively connected" concept, thereby repealing the application of the force of attraction principle in the vast majority of cases. While the two pieces of the statutory landscape may be closely related, on what authority can the amendment of one affect the interpretation of the other? There are two responses to this question.

The first response is that it has happened before. Consider the case of depreciable useful life as a predicate for the depreciability of tangible assets. The traditional understanding of the depreciation allowance was that taxpayers were permitted to deduct depreciation allowances only if they were able to establish assets' depreciable useful lives.<sup>259</sup> That principle arose as an interpretation of language in Section 167(a) that Congress has not in any manner amended. Nevertheless the 1981 adoption of ACRS in the form of Section 168<sup>260</sup> did rework the depreciation regime in a manner that made continued adherence to the depreciable-useful-life standard unjustifiable.

The depreciable-useful-life standard came into existence at a time when cost recovery periods were tied to actual depreciable lives. ACRS severed that connection, establishing arbitrary relatively short recovery periods for all tangible assets. Congress prescribed five-year cost recovery for all tangible personalty not assigned to some other category.<sup>261</sup> Further,

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257. LLEWELLYN, *supra* note 177, at 42-43 (emphasis omitted).

258. Pub. L. 89-809, § 102(d)(2), 80 Stat. 1539, 1544-45 (1966).

259. See *Associated Obstetricians & Gynecologists, P.C. v. Comm'r*, 762 F.2d 38, 39-40 (6th Cir. 1985); *Hawkins v. Comm'r*, 713 F.2d 347, 353-54 (8th Cir. 1983).

260. Economic Recovery Tax Act of 1981, Pub. L. 97-34, 95 Stat. 172, 203 (1981).

261. Under existing law, the pertinent catch-all category is seven-year cost recovery. See I.R.C. §

Congress set all salvage values to zero, thereby eliminating the mechanism that ensured the non-depreciability of assets that tend to appreciate rather than to exhaust themselves over predictable useful lives. The depreciable-useful-life standard was inconsistent with the new statutory environment Congress had created, and the courts wisely set it aside.<sup>262</sup> In the same manner, the “trade or business within the U.S.” language was affected significantly by Congressional amendment of other Code language with which it interacts.

This in turn leads to a second justification for this line of reasoning. Although the assertions in dicta of a minimum quantitative threshold purport to be interpretations of the “trade or business within the U.S.” standard, they are better understood as interpretations of the interaction of that standard and the force of attraction principle.<sup>263</sup> They interacted in a manner that was perceived as creating a potential for abuse. The quantitative threshold responded to that interaction. Once that interaction was ended, the justification for the interpretation also ended. In fact, the object of interpretation—the interaction—ceased to exist, and with it the basis of the interpretations also ceased to exist.

A diligent search for decisions applying to taxable years beginning after 1966 has not produced any cases that both refer to a minimum quantitative threshold and in which that standard was necessary to the resolution of the factual scenario presented. That is, the diligent search has found no post-1966 cases rejecting *Proposition 3* in which the rejection was necessary to resolve the factual questions presented. In fact, it has found only two such authorities even asserting a dependence on an analysis of regularity, continuity, and considerableness of U.S. activity. Neither of these asserts any particular justification for so doing, and in neither was that standard a necessary minimum condition for the actual disposition of factual scenario under consideration.<sup>264</sup> This should not be surprising. Congress eliminated whatever perceived need there was for a minimum quantitative threshold.

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168(e)(3)(c) (2008).

262. See, e.g., *Simon v. Comm’r*, 103 T.C. 247, 263 (1994), *aff’d*, 68 F.3d 41 (2d Cir. 1995); *Liddle v. Comm’r*, 103 T.C. 285, 290 (1994), *aff’d*, 65 F.3d 329 (3d Cir. 1995). See also Anthony P. Polito, *Fiddlers on the Tax: Depreciation of Antique Instruments Invites Reexamination of Broader Tax Policy*, 13 AM. J. TAX POL’Y 87 (1996).

263. This essential interaction is easy to overlook because the Code had no explicit reference to the force of attraction principle. Its existence had to be inferred from the structure of the provisions imposing net basis taxation on all U.S. source income of a foreign taxpayer engaged in a trade or business within the United States. See, e.g., Revenue Act of 1936, Pub. L. 74-740, ch. 690, §§ 211, 231, 49 Stat. 1648, 1714-15, 1717 (1935-36).

264. See *Perez v. Comm’r*, 56 T.C.M. (CCH) 312 (1988); Rev. Rul. 73-522, 1973-2 C.B. 226.

## IX. CONCLUSION

The mission of this Article has been the interpretive clarification of what it means to conduct a trade or business within the United States. In the age of globalization and electronic commerce, it may well be that significant modifications to the existing standard might be warranted. As a matter of policy, some of the existing thresholds to U.S. net basis taxation may even have outlived their usefulness.<sup>265</sup> Nevertheless, no consensus has yet emerged around any policy alternatives, and it is far from clear whether any such proposals represents superior policy to existing law. This Article has sought to facilitate the discussion of the policy issue by establishing an interpretive baseline; bringing interpretive clarity to the existing threshold to U.S. net basis taxation.

The key analytical step in achieving that clarity was to disentangle that inquiry into two distinct inquiries:

- Is the foreign taxpayer engaged in a trade or business?
- Is the conduct of the trade or business “within” the United States?

The resulting set of interpretive propositions create a clearer framework for addressing live questions under the Code. In concluding this interpretive essay, a few last words about the crucial role of *Proposition 3* are in order.

In *Proposition 3*, this Article asserts that, notwithstanding references to the contrary in judicial opinions and revenue rulings, a foreign taxpayer’s U.S. activities need not be regular, continuous, and considerable to bring a foreign trade or business into the United States. Congress eliminated the one plausible justification for interpreting the Code to require such a minimum quantitative threshold, and even before that legislative action one is hard pressed to find any reported decisions actually depending upon it. On the other hand, one can find numerous such decisions depending upon qualitative grounds for excluding a foreign trade or business from being conducted within the United States without regard to a quantitative threshold, and also decisions in which quantitatively minor U.S. activities did bring a foreign trade or business into the United States.

Under existing law, the most reasonable interpretive assimilation of the pertinent authorities into a big picture is clear. The *quantitative* analysis determines whether a taxpayer conducts a trade or business at all. The analysis of whether a foreign trade or business has been brought into the U.S. is purely *qualitative*.

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265. See *supra* note 21 and accompanying text.